

China's Leadership Transition: What's at Stake?

Conference Report

Dr. Alison A. Kaufman

CNA CHINA STUDIES



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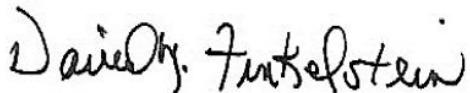
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Executive summary

On September 12, 2012, CNA China Studies held a conference to examine the implications of the leadership transition that was about to take place at the 18th Party Congress of the Chinese Communist Party.

This report discusses five key themes that emerged in the conference.

- *Party Congresses are important because they mark a transition both in personalities and in policy.* The identity of the individuals ascending to China's highest Party and military positions was revealed by the end of the 18th Party Congress. But how China's new leadership will assess China's many domestic and international challenges, and what policy approach they will take in order to meet those challenges, will unfold over many months and years.
- *The 18th Party Congress comes at an especially critical time for China.* Conference speakers emphasized the large and myriad challenges facing China's leadership, particularly in domestic economic and social issues. Speakers stressed that China's remarkably high rates of economic and social development over the past three decades simply cannot be sustained if the Chinese continue along their current path. Without a major change in policy direction, China's new leaders will find it increasingly difficult to maintain economic growth, social stability, and Party legitimacy.
- *China's new leaders will face many limitations on their ability to take a new policy direction, even if they want to do so.* Conference speakers identified three major limitations: (1) China's unique model of collective, consensus-based decision-making; (2) the Party's sensitivity to public pressure; and (3) China's interdependence with other countries.
- *The rest of the world is deeply invested in China's policy decisions.* Our speakers noted that U.S., regional, and global interests are increasingly affected by China. As a result, China's leadership transition is being closely watched by the U.S. and by China's neighbors. These countries all seek to engage with China in the economic, diplomatic, and security realms, for the stake of stability and prosperity. But there remains a wide range of political and regulatory obstacles to productive engagement.
- *Misperceptions and mistrust constrain the ability of leaders in China, the United States, and other countries to move their relationships forward.* Further narrowing the space for positive engagement is the fact that many people in China, the United States, and the Asian region do not understand each other very well. Negative perceptions in turn can lead to suboptimal policies. Conference speakers discussed varieties of both public and governmental efforts that could address this issue.

Part I: Conference highlights

Introduction

From November 8th to 14th, 2012, the 18th National Congress of the Chinese Communist Party (CCP) convened in Beijing. By the time the Party Congress ended, most of the figures who had ruled China for the previous decade had stepped down, and were replaced by a new cadre of leaders. For only the fifth time in the history of the People's Republic of China (PRC), a new leader – Xi Jinping – has taken his seat as the Secretary-General of the CCP, and as the presumptive next President of the PRC. Many of China's high-level Party and military positions also turned over. These changes will be followed by a similar transition in the major state organs at the National People's Congress in spring 2013. Thus, by March or April 2013, a "fifth generation" of leaders will have taken center stage in China.

While this process has become increasingly routinized over the past decade, key uncertainties persist: What will be the policy priorities and agendas of the new leadership? How much influence will the many Chinese bureaucratic voices and interests have in the new administration? The answers to these questions are crucial to the futures of both China and the rest of the world.

On September 12, 2012, CNA China Studies held a conference in Washington, D.C., that brought together a group of expert commentators to explore the many challenges and questions that face China, the United States, and the world on the eve of this transition. The speakers

approached their topic through four key questions:

- What's at stake for China itself?
- What's at stake for U.S.-China relations?
- What's at stake for U.S. business?
- What's at stake for the region?

What is at stake?

Broadly speaking, what is at stake is nothing less than the potential transformation of the world's largest developing economy, largest Communist nation, and most prominent rising power. The 18th Party Congress has come at a critical moment for China, as that country faces an ever-growing list of challenges and opportunities. The Party Congress provided an early window into how the fifth generation of Chinese leadership will characterize and address these many challenges.

As these new leaders assume their posts and begin to direct policy for the next decade, they will face a key set of choices. Their decisions cannot be foreseen. Domestically, it is unclear whether the new generation of leaders will be open to much-needed economic and social reforms. Internationally, there is substantial ambiguity about how China will want to position itself in the global arena.

This uncertainty poses a challenge for policy-makers and observers around the world. Because of China's increasingly prominent position in the global arena, its

decisions on how to resolve domestic issues will reverberate well beyond its own borders. We do not know whether China's new leaders will have the will or the capacity to take on productively the many challenges that await them.

The next section of this report highlights five key themes from the conference discussions. The conference agenda and speaker biographies are in Parts II and III. A full transcript of the event follows in Part IV.

Five themes

Theme #1: The 18th Party Congress represents two transitions: A leadership transition and a policy transition

China's leadership transition took place at the 18th Party Congress

When the 18th Party Congress convened, it ended years of outside speculation about who would lead China into the next decade. Party Congresses are five-yearly meetings of the Chinese Communist Party that formalize the succession to top Party positions and major changes to the top military leadership. The identities of those named to key positions are announced at the Party Congress and at the First Plenary Session of the new CCP Central Committee that follows immediately after the Party Congress ends.

The process preceding this leadership transition has become increasingly routinized, if not entirely predictable. The first conference panel examined this process in some detail. Dr. Alice Miller of Stanford's Hoover Institution noted that Chinese leadership succession has, over the past two decades, become a "much more institutionalized and routinized political process" than the "faction-driven free-for-all competition" of the late 1960s

and early 1970s. Miller identified a series of routine events that take place prior to the convening of the Party Congress itself, including provincial Party congresses, a major policy speech by the current CCP General Secretary to the Central Party School, and a schedule of meetings by the Politburo Standing Committee.

Moreover, as was pointed out by both Miller and Dr. Kenneth Lieberthal, Senior Fellow in Foreign Policy and Global Economy and Development at the Brookings Institution, the people ascending to leadership positions in the CCP are drawn from an increasingly professionalized political class. Lieberthal noted that these figures have been well vetted through a "sophisticated path to higher office" that is far more meritocratic than in previous generations: they need to have spent time in both provincial and central positions and to have shown positive results. Miller added that senior members of the CCP are now selected in large part for their experience and expertise, not just their political connections. When they ascend to higher office, they will follow a division of responsibility along professional, rather than factional, lines.

What changed at the 18th Party Congress?

- **CCP Secretary General** Hu Jintao stepped down and was replaced by current CCP Deputy Secretary General, Xi Jinping. In keeping with past practice, Xi is also expected to be named PRC President in spring 2013.
- The **Politburo Standing Committee** (PBSC) – the center of gravity of collective power in China – retired seven of its members and replaced them with five new people. This brings the body down from nine members, which it has had since 2002, to just seven.
- The full **Politburo** replaced 15 of its 25 members.
- Xi Jinping was named **Chairman of the Central Military Commission** (CMC) of the CCP Central Committee. Hu Jintao stepped down from the CMC – in stark contrast with his predecessor, Jiang Zemin, who retained chairmanship of the CMC for two years after stepping down from his other official positions.
- Seven out of 10 generals on the **Central Military Commission** were replaced.
- A new **Central Committee of the Chinese Communist Party** was established. 205 members were elected, along with 171 alternates. Nearly half of the full members were newcomers.
- A new secretary was announced for the **Central Discipline Inspection Commission**, a powerful internal CCP organ.

China's policy transition will occur only after the Congress

While the 18th Party Congress settled lingering questions about *who* will lead China into the next decade, it will not immediately be clear *what* they will want to do or *how* they will do it. The Party Congress finalized the leadership transition process, but is only the beginning of an equally – if not more – important policy transition. This will unfold over many months and years, and at present we know very little about the direction in which China's new leadership will want to take the country. As is noted

later in this report, many observers – both inside and outside China – feel that deep, fundamental policy reform is needed; but it is not at all clear whether China's new leaders will agree with this assessment. At present we can only speculate about how the new leadership will characterize China's key challenges, how they will prioritize addressing these challenges, and how they will view China's international environment.

Some early indications of the new leadership's preferred direction began to emerge at the 18th Party Congress. As Dr.

Miller pointed out, ever since Deng Xiaoping launched the reform era in the late 1970s, the function of Party Congresses has been not only to formalize the leadership transition, but also to provide a public arena for revising the Party's constitution and for outlining broad policy guidelines for the Chinese leadership's work before the next Party Congress. In the "political report" they present at the Party Congress, the new leadership essentially passes judgment on the policy successes and failures since the previous Party Congress five years earlier, and lays out the key policy priorities for the incoming leaders. Thus, it is in this venue that the new leaders publicly states whether they believe that a new policy direction is needed.

It is only *after* the Party Congress, however, that these new leaders will translate these general policy priorities into a concrete policy agenda. When might we expect to see this personal stamp being put on the fifth generation's leadership? Miller noted that if Xi follows in Hu Jintao's footsteps, he could begin to do so within the first one to three years of his ascent.

"The adjustments that the 18th Party Congress may make in the leadership structure and the process of policy-making will provide an important indication of how China's leaders see the problems of governance that they face and how they are moving to address them."

— Alice Miller, The Hoover Institution

Theme #2: China is in trouble

Across all the panels, conference speakers highlighted a host of extraordinarily difficult domestic challenges that China's new leaders will face. The speakers emphasized that the only way the leaders can adequately address these challenges is through large-scale reforms in China's approach to economic development and management – but that it is not at all clear whether they will do so.

China faces a myriad of domestic challenges

Conference speakers provided a long list of issues that will challenge the health, prosperity, and well-being of China's citizenry going forward. These included:

- Growing gaps between the incomes and influence of rich and poor, between the economic prospects of urban and rural areas, and between the development of the eastern, coastal regions of China and the western, interior areas
- Environmental degradation, which harms health, constrains economic growth and energy development, and raises questions about water and food security
- A rapid demographic shift, from a youthful society to a quickly aging one, at the same time that China's social safety net has weakened
- The need to sustain economic growth in the midst of a global economic downturn

- The need to rebalance China's long-term economic growth strategy to meet a changing global economy
- A bureaucratic incentive and promotion system that encourages corruption and discourages policy innovation.

For China's new leadership, these policy issues will be made even more pressing by the fact that they receive a great deal of public attention. Citizens' concerns about the PRC leadership's ability and willingness to address these issues have challenged domestic stability and support for the CCP. Frequent and often large-scale public protests or "mass incidents" have numbered over 100,000 annually in many recent years. Internationally publicized incidents, such as the Wukan village protests in 2011 that targeted corrupt local officials, have highlighted the fact that policy decisions in China are now widely discussed and critiqued by the Chinese public. Many of these critiques are disseminated widely through only partially controlled social media.

Several conference speakers alluded to the broader issue faced by the CCP in tackling China's economic and social problems: the need to keep the citizenry happy and stable. CCP legitimacy in the current era rests largely on the Party's demonstrated ability to ensure the prosperity and well-being of the Chinese people. Yet, as is highlighted in the next section of this report, it is not at all clear that the Party can deliver on this promise without undertaking major reforms. If it does not deliver, the CCP is likely to face significant challenges to its very identity as the legitimate ruling party of China.

The status quo is not an option

The consensus among the conference speakers was that these myriad challenges are coming to a head. While many of these concerns about economic inequality and Party legitimacy are long-standing, speakers asserted that China's current model of domestic governance and economic management is now at a breaking point. Specifically, they argued that China's remarkably high rates of economic and social development over the past three decades simply cannot be sustained if the Chinese continue along their current path.

"China's very successful development model has now largely run its course, and the costs of not shifting to a new model are rapidly rising."

— Dr. Kenneth Lieberthal, Brookings Institution

As characterized at the conference, China's current economic model has focused on rapid growth, based on economic and trade strategies such as top-down planning; labor-driven, export-oriented production low in the international value chain; high domestic savings rates; and high domestic investment in infrastructure and heavy industry.

This economic model sustained remarkably high levels of growth for many years. As several conference speakers pointed out, however, this model has now run its course. Lieberthal and James Fallows, longtime senior correspondent at *The Atlantic*, both noted that the PRC's emphasis on infrastructure and heavy industry has become largely inapplicable in a period when China

wishes to promote growth in the service sector and in higher-end production. Reports in the second quarter of 2012 that China's economy is slowing down have raised a number of questions about whether China can or should maintain the very high levels of exports, savings, and domestic investment that have characterized the economy in recent decades.

Moreover, so long as China's economy was growing rapidly, many of the social changes arising during the reform era – such as the loss of the “iron rice bowl” that provided social benefits to all workers, massive migration from rural to

urban areas, and the frequent displacement of local residents in favor of large-scale development projects – were largely ignored. The social and economic impacts of environmental degradation, too, were underemphasized. Today, however, the social consequences of economic reform are almost impossible to ignore.

Lieberthal outlined several assumptions on which the reform model of economic development has been based – and explained why each of them no longer holds true. His comments are summarized in the box below.

Outdated economic assumptions (Dr. Kenneth Lieberthal)	
Assumption	Why it is no longer applicable
“A virtually unlimited supply of flexible, young, cheap labor”	Demographic transition to an older society, with a much smaller percentage of the population at working age
An international market that “would be receptive to rapidly growing Chinese exports for many years into the future”	Global economic slowdown, particularly in advanced industrial nations Growing economic protectionism in many nations
Capacity to grow now, and manage the environmental consequences later	Chinese environmental devastation is “constraining economic growth and imposing high economic, social, and political costs”
“Sufficient popular tolerance for the growth of corruption and inequality” as necessary costs of the transition from a planned to a market economy	Many wealthy Chinese no longer trust the system to protect their assets Chinese public is increasingly intolerant of official corruption
Top leadership would have autonomy to make long-term, effective policy	Chinese leadership model has moved toward collective, consensus-based norms that make it much more difficult to make necessary reforms

China is at a decision point

As a result of these changes in the world and within China, the new PRC leadership will need to make a number of decisions about how to orient China's domestic and foreign policy in the next decade. Lieberthal pointed out that many in China's top government positions are well aware that the current economic model needs changing, to one that is more oriented toward domestic consumption, higher value-added production, greater social equity, and environmental protection. Recommendations to this effect have been made both in China's 12th Five Year Plan, adopted by the PRC National People's Congress in 2011, and in a 2012 report jointly authored by the World Bank and the PRC State Council Development Research Center.¹ Yet, he noted, there has also been domestic opposition in China to the findings of these reports, and a number of difficult choices would need to be made to push such reforms through. As discussed under theme #3 below, making such choices may turn out to be very difficult for the new leadership.

Theme #3: China's new leaders will face many limitations on their ability to undertake a new policy direction

A key question that emerged during the conference is whether China's leadership has the *will*, the *incentive*, and the *capacity* to undertake these essential domestic reforms. Throughout the day, speakers highlighted a number of sometimes

conflicting domestic incentives and pressures that limit the PRC leadership's ability to make bold policy moves.

China's unique decision-making model makes it difficult for China's leadership to pursue the bold policy changes needed for domestic reform

The first factor is China's unique model of high-level decision-making, which stresses collective leadership and the necessity of consensus.

- In China, policy decision-making today is *collective* – there is a small core of top-level officials who together constitute the leadership of China. The CCP General Secretary today is a “first among equals,” rather than a “paramount leader” like Mao Zedong or Deng Xiaoping. CCP General Secretary/PRC President Hu Jintao and, to a somewhat lesser degree, his predecessor Jiang Zemin, needed to build strong support among their colleagues in the Politburo Standing Committee, the Central Military Commission, the CCP Central Committee, and other top-level bodies before they could make major policy changes.
- Further complicating this picture is the fact that China's top-level decision-making is also *consensus based*. In these high-level government bodies, the preferences of the majority may not take precedence over those of the minority. Rather, all major decisions are expected to be reached by a unanimous consensus among all members of that body. Dr. Lieberthal and Dr. Miller noted that this consensus-based norm of decision-making has become especially

¹ *China 2030: Building a Modern, Harmonious, and Creative High-Income Society* (Washington, D.C.: The World Bank, 2012). <http://www.worldbank.org/content/dam/Worldbank/document/China-2030-complete.pdf>.

prominent during Hu Jintao's administration.

Many of the conference speakers argued that these two norms of decision-making – collective and consensus based – result in an extreme diffusion of authority, which in turn will place a substantial constraint on the ability of the incoming leadership to make major policy changes, no matter how pressing.

The first implication of collective, consensus-based leadership is that China's top leader cannot make policy by himself. As a result, the question of how reform-minded an individual leader is may be somewhat beside the point, since he cannot easily push through reforms on his own. Rather, we need to ask how reform-minded the entire leadership community is – and which of their individual or bureaucratic interests would be served by reform.

Related to the latter point is a second implication: long-term thinking can easily be hamstrung by the bureaucratic interests and constituencies of the members of the top leadership bodies. For instance, each member of the Politburo Standing Committee holds a "portfolio" of issue areas for which he or she is largely responsible. These areas largely correspond to a specific set of bureaucratic institutions, such as those related to domestic security, economic development, or propaganda. Lieberthal noted that this has always been true in the PRC, but that the consensus model has now made it almost impossible to make any reforms that would harm the interests of any of these constituencies. Moreover, individual leaders often have

ties to powerful corporate interests, in a "marriage of wealth and power" that would be curtailed by much-needed structural reform and anti-corruption measures.

Finally, difficult decisions about resource allocation and structural reform are far more likely to be tabled than to be resolved. Thus, as several conference speakers pointed out, the norms of collective, consensus-based decision-making significantly constrain the ability of China's current governing institutions to make rapid, major policy changes – and thus to tackle head-on the urgent need for reform. In the views of several conference speakers, the future of China's reform efforts will rest in large part on the willingness of China's new leaders to step back from the extreme consensus orientation that has characterized the Hu Jintao era, and to reconcile the interests of the major constituencies in support of reform.

Consensus-based decision-making has benefits for foreign policy

Several speakers pointed out that although collective leadership and consensus-based decision-making put significant constraints on policy-making, these norms also provide incentives for stability, particularly in the realm of foreign policy. Dr. Alice Miller noted that consensus-based policy-making tends to prevent the rise of strongmen with extreme policy agendas, such as Mao or Stalin. Former Deputy Secretary of State and current Dean of Syracuse University's Maxwell School, James Steinberg, noted further that the relative conservatism of China's collective leadership has helped to keep relations with other countries on a relatively even keel, with a focus on continuity and a strong "desire to right the boat during periods of tension."

Singapore's Ambassador to the United States, Mr. Ashok Mirpuri, provided an additional perspective on consensus-based decision-making in his comments on similar norms that underpin the Association of Southeast Asian Nations (ASEAN). Because these norms prevent larger member states from imposing their interests on their smaller brethren, they force all 10 member states to balance national and regional interests. Yes, decision-making can be slow. And on rare occasions, the entire process can break down – as with the failure at the 2012 ASEAN summit to issue a joint communiqué, for the first time in ASEAN's 45 years of existence. But usually, he noted, the need to reach consensus will make all the members more likely to think in terms of their long-term relationships and regional stability, rather than focus solely on immediate, national-level concerns.

Sensitivity to public pressures may limit leaders' policy options

Another factor that multiple speakers noted as limiting the flexibility of China's incoming leadership is the increasing clamor of the Chinese people – some of whom do not support domestic reform or international cooperation. This is particularly salient for foreign policy: as China's international influence continues to grow, the leadership must make important determinations about how to situate their country in the international arena. China's new leaders are likely to focus on urgent domestic issues; but Chinese citizens have historically judged their government in part on their perceptions of its ability to stand up to

foreign pressures. As several conference speakers noted, increasingly loud cries of anti-foreign nationalism across China may put great pressure on China's leadership to act on the international stage in ways that are counterproductive to building stronger bilateral, regional, or global relationships. On issues of sovereignty and territory, which have been enshrined as a "core national interest" in Chinese popular and political rhetoric, China's leaders face especially strong public pressure not to be seen as folding to international demands. But other domains are also susceptible to policies driven by nationalism. Former U.S. Trade Representative Carla Hills and Dr. Douglas Paal, Vice President for Research at the Carnegie Endowment for

International Peace, both noted that in an era of heightened sensitivities, economic disagreements are easily translated into economic nationalism in both the United States and China – making it more difficult for policy-makers to pursue economic cooperation while simultaneously appeasing domestic constituencies.

Suspicion of foreign intentions has always played some role in modern China's political milieu. In recent years, however, the spread of social media such as microblogging and electronic bulletin boards means that these voices are louder and more widespread than in the past. James Fallows characterized nationalism as the single issue on which China's otherwise extraordinarily diverse and often divided public can come together.

Thus, as James Steinberg noted, nationalism can act as a crucial unifying element for a Chinese government whose domestic prowess may otherwise be under question. Much Chinese nationalism has been reactive: China's government and people have responded to perceived threats to China's territory or dignity. Lieberthal cautioned that exactly such an outcome could result if the United States pushes a newly arrived Xi Jinping on foreign policy issues. There have also been concerns in recent years that China's government is taking a more proactively assertive or even aggressive stance in the Asian region. Ashok Mirpuri, Ambassador of Singapore to the United States, noted that at least some Southeast Asian observers fear that one outcome of Chinese nationalism could be that the Chinese government finds it more difficult to adopt conciliatory positions.

"The CCP's legitimacy problem may lead them to call on public opinion in destabilizing ways."

— Former Deputy Secretary of State James Steinberg

Interdependence with other countries limits the ability of China's leadership to eschew cooperation

These pressures notwithstanding, the conference also highlighted compelling reasons to think that China's new leadership would be unwilling or unable to take China in a highly uncooperative direction. Steinberg pointed out that the current generation of Chinese leadership has worked very hard to stabilize U.S.-China relations, even in the face of sometimes grave tensions over the past several years. The collective leadership system tends to perpetuate such "conservative instincts," he noted, and thus it is likely that we would see a similar "instinct for stability and continuity" following the leadership transition.

More broadly, many global issues that touch on China's interests, such as protecting Chinese assets and citizens overseas or maintaining a stable global financial environment, are too big for China to take on alone. Thus, the Chinese leadership has a vested interest in maintaining a cordial relationship with its neighbors and with the United States in order to deal cooperatively with such issues. Dr. Alison Kaufman of CNA pointed out that every country has a "floor" to its relationships with other nations – a level of contact and engagement below which that country's leadership is unlikely to let

relationships deteriorate. For China and the United States, for instance, it is unlikely that either country would allow the level of economic engagement to fall drastically, because the economic effects would be so great that they could destroy leaders' domestic political support on both sides. Such considerations may be especially important in a time of transition, when the new Chinese leaders need to build up their domestic political capital and reassure the Party and the Chinese people that they can maintain order, stability, and prosperity for China over the next decade. As Lieberthal said, Xi Jinping will probably be "cautious and calm about international relations in order to deal with domestic issues."

"China has never [before] had so many complicated relationships overseas."

— Dr. Douglas Paal, Carnegie Endowment for International Peace

Theme #4: The rest of the world is deeply invested in China's policy decisions

Many of the conference discussions centered on the impact that China's domestic policies will have on the rest of the world. The decisions of China's new leadership will also affect the prosperity, security, and stability of many other nations – including the United States and China's nearest neighbors in Southeast Asia.

This is a critical time for U.S.-China relations

James Steinberg asserted that the U.S.-China relationship is "the most significant state-to-state relationship in the world today ... central to both countries' future" – and that it is currently "entering into one of the most consequential periods" since 1989, or perhaps even since normalization in 1979. In the United States, uncertainties about China's intentions and capabilities create anxieties about the challenges that a rising China might pose to U.S. global security and diplomatic concerns – creating what Steinberg characterized as a "period of great uncertainty in the nature of the relationship as it's going to go forward."

On the economic front, Ambassador Hills pointed out that today's "fragile global economic environment" makes the United States and China each more vulnerable to economic weakness in the other. The potential implications of such vulnerability were underscored by a number of statistics provided by Ambassador Hills, by Mr. Nelson Dong of Dorsey Whitney LLP, and by Ambassador Mirpuri. These statistics, summarized in the box on the next page, indicate both China's economic importance in global terms and the interdependence of China's economy with the United States and with other countries in the Asia-Pacific region.

China's global economic importance

(Statistics provided by Ambassador Carla Hills, Mr. Nelson Dong, and Ambassador Ashok Mirpuri)

As of late 2012, China:

- Is the world's second largest economy in terms of GDP
- Is the world's largest exporter
- Contributed 16 percent of global GDP growth over the previous two years
- Is one of the world's largest recipients of foreign direct investment (FDI).

For the United States:

- China is the U.S.'s third-largest export market, totaling \$104 billion in 2011
- U.S. exports to China have grown faster than those to anywhere else in the world, increasing over 500 percent since 2001, when China entered the World Trade Organization (WTO)
- China is the only country in the world that has provided the growth rate needed to meet President Obama's goal of doubling U.S. exports by 2014
- U.S. exports to China come from every U.S. state. Forty-eight U.S. states report that their exports to China have tripled since 2001; nearly half of these showed a fourfold increase
- The largest U.S. export to China is crop production
- China is the world's largest supplier of imports to the United States
- Eighty percent of U.S. companies responding to an October 2011 survey reported double-digit revenue growth from the Chinese market for the year; nearly half reported an increase of over 20 percent.

For Southeast Asia:

- China is the largest trading partner of the Association of Southeast Asian Nations (ASEAN)
- ASEAN is China's third-largest trade partner.

China's transition is being closely watched in the region

How China handles its leadership and policy transition is not just of interest to the United States. The final conference panel focused on the question of how regional countries, particularly in

Southeast Asia, view China's current position. Ambassador Mirpuri noted that China's future policy decisions will have a major impact on the 10 countries in ASEAN. The trade relationship between ASEAN and China is very important, as also noted in the box above, and has been bolstered by the recently implemented

ASEAN-China free trade agreement. At the same time, China has maritime territorial disputes with four ASEAN countries. Thus, ASEAN members will closely watch China's new leadership, to see how they choose to pursue those claims.

There is also a broader concern among Southeast Asian nations about how U.S.-China relations will unfold and how this will affect the region. Mirpuri noted that the strategic importance of ASEAN arises from its location on two major sea lines of communication: the Indian Ocean and the Asia-Pacific region. As a result, noted Doug Paal, regional countries "depend on an orderly global environment," in which they can "rely on a ... structure of post-Cold War security mechanisms and economic mechanisms to provide for peace and prosperity." If these mechanisms of cooperation begin to break down, due to economic or security rivalries, regional countries will be caught in the middle.

"[Southeast Asian nations] don't want to be a pawn or a proxy in a big power rivalry."

— Mr. Ashok Mirpuri, Singapore's Ambassador to the United States

The world seeks to engage China – and China, for the most part, seeks to engage the world

As CNA's David Finkelstein put it, the increasingly intertwined nature of U.S. and Chinese global interests and concerns both "impels and compels" the two governments to cooperate. The same is true for China's relations with regional countries. The desire of other countries for productive cooperation with China

was stressed repeatedly throughout the conference.

Senior officials from the United States have, for instance, repeatedly stated their strong desire to engage China as a responsible, equal partner in addressing the many global issue areas that affect both countries, such as climate change, counter-terrorism, and world-wide economic and financial downturn. Steinberg, Hills, and Mirpuri all viewed such cooperation as a foundation for building trust and maintaining regional and global stability. Ambassador Hills, referencing a recent statement by Xi Jinping, noted that a strong bilateral economic relationship can act as a "ballast" to "keep our bilateral relationship on a steady and positive course" even in the face of difficult diplomatic and security concerns.

Steinberg, Hills, Mirpuri, and other speakers also pointed out that China's leaders have many incentives to pursue cooperative global and regional relationships. Chief among these is the fact that China's domestic prosperity and stability depend on the persistence of a peaceful external environment. There was a general consensus that China's reform-era leadership has been quite aware of this dynamic and has taken steps to build ties with and reassure other countries in the region and globally. Ambassador Hills, for instance, observed that China's current leadership has accommodated many of the economic and financial demands of the global system: as a result of the market openings required by the WTO accession agreement, China has reduced its import tariffs, eliminated many import licenses and quotas, relaxed some ownership restrictions on foreign businesses, and permitted foreign

companies to compete in some sectors previously closed to them. Ambassador Mirpuri recalled that during the 1990s China's leaders viewed economic and diplomatic engagement with ASEAN nations as a way to show the world that its rise would be peaceful and non-threatening.

But many also view engagement with China as difficult

Even so, many tensions remain in China's relationship with its neighbors and with the United States that make cooperative engagement more difficult. Hills and Dong both pointed to ongoing complications for U.S. businesses seeking to work in China, including:

- trade restrictions
- rising operating costs
- difficulties for foreign companies making local hires
- inadequate international property rights protection
- regulatory restrictions on foreign direct investment and government procurement
- lack of regulatory transparency
- lack of market access in the legal, financial, information technology, and telecoms sectors.

Together, such complications add up to favoritism for Chinese firms. Mr. Dong noted that the future of these and other economic and business policies will be directly determined by the incoming Chinese leadership.

On the diplomatic and security front, Ambassador Mirpuri noted that ongoing disputes between China and some ASEAN members over the South China Sea have raised tensions between those countries and China, and have highlighted disagreements within ASEAN on how to deal with a rising China. As a result, the next generation of Chinese leadership will inherit a China-ASEAN relationship that "is generally cooperative ... but with considerable uncertainty over how China will engage in the region in the future." For the United States, too, the interaction between China and its neighbors adds an additional complicating factor to the bilateral relationship.

Chinese foreign policy will take place against a backdrop of domestic concerns

All the conference speakers agreed that Chinese foreign policy-making going forward can only be understood against the backdrop of the many domestic concerns highlighted earlier in this report. There was a general consensus that China's new leadership must and will prioritize the management of internal challenges – and that they will weigh their decisions on international issues against their probable impact on China's domestic environment. So long as they view China's domestic interests as best served by cooperation in the international arena, future foreign policy is likely to be oriented in that direction.

Theme #5: Misperceptions and mistrust constrain the ability of leaders in China, the United States, and other countries to move their relationships forward

Throughout the day, speakers pointed to the fact that many people in China and the United States – and in other countries in the Asian region – do not know or understand each other as well as they should. This narrows the space for positive engagement.

The American public displays a lack of knowledge about China

Several conference speakers discussed what Carla Hills labeled a “knowledge gap”: the fact that people in the United States and in China simply do not know enough about each other’s circumstances. This was the central message of James Fallows’ lunchtime address. Fallows asserted that many popular American views of China are based in part on “mistaken assumptions” about the strength of China’s domestic economy, its military power and ambitions, and the government’s “omni-competence” to manage domestic problems and foreign policy. This overstatement of PRC government’s capacity can, in turn, lead to an assumption that any problems in the bilateral relationship are deliberate on the part of China’s leadership.

On the economic front, Hills and Dong noted that many Americans fundamentally mischaracterize the economic relationship between the United States and China, overstating the significance of the U.S. trade deficit with China and underestimating the importance of China as a market for U.S. goods and a destination for U.S.

investment. This misunderstanding can exacerbate the perception among business people in both countries that they do not face a “level playing field” (as Dong put it) in the other.

“The fact is that our economies are complementary.”

— Ambassador Carla Hills, Former U.S. Trade Representative

Negative perceptions narrow the space for positive engagement

This knowledge gap, coupled with very real divergences in the two countries’ economic, diplomatic, and security interests, can in turn lead to high levels of mistrust in both countries. Hills and Steinberg both referenced recent public opinion polls that show significant portions of both the U.S. and the Chinese populace characterizing the other in negative terms, indicating what Hills called a “trust deficit” between the two countries.

Such views have crucial implications for China’s relations with its regional neighbors and with the United States. Most important is that these negative views easily translate into oversimplified, negative characterizations of the other country’s aspirations and intentions – which in turn can make it more difficult for leadership on both sides to pursue positive relations. Fallows asserted, for instance, that “the American public ... would like to have very clear black/white, good/bad, ... friend/foe-type distinctions” for understanding U.S. foreign policy relationships. In an era when there is a real uncertainty in both the United States and China on “how to characterize where

we are [in the bilateral relationship] and where we're going," Steinberg pointed out, the specific label that each side uses for the other – partner, friend, competitor, rival – "tends to bring with it an associated set of policy prescriptions: cooperate, engage, confront, contain," and so on. He praised current U.S. and Chinese foreign policy leaders for choosing to characterize the bilateral relationship simply as "unprecedented" rather than using a more provocative label.

Increasing levels of mistrust about China's intentions are indicated by the fact that citizens and leaders of many countries appear increasingly disinclined to put positive labels on China's actions when its signals are ambiguous. From the perspective of China's Southeast Asian neighbors, for instance, Ambassador Mirpuri noted that China's growing economic and military weight has prompted increased regional scrutiny and negative characterizations – which have appeared to be borne out as territorial disputes have come to dominate China's relationship with the four ASEAN member states of Vietnam, the Philippines, Malaysia, and Brunei. Commentator Douglas Paal asserted that China's regional activities over the last several years have "scared" the region so that Asian countries have unified around that fear.

These perceptions matter because they can be difficult to dispel. As Steinberg pointed out, once a particular characterization of the U.S. relationship with China (or any country's relationship with China) and its associated policy prescription have come to be taken as conventional wisdom, it can become more difficult to justify changing policy direction. Mirpuri noted further that after

a given country acts on disputes – for instance, after China's creation of the Sansha administrative region covering the disputed Spratly and Paracel Islands – it can be very difficult to back away from those choices in the future. And Kaufman pointed out that uncertainty about intentions, and expectations that are either unrealistically high or unrealistically low for the bilateral relationship going forward, are likely to be especially high in a period of leadership transition.

"In a time of transition, it is easy to develop unrealistic expectations for what the other country's leadership may be willing or able to do."

— Dr. Alison Kaufman, CNA

Greater public and leadership efforts are needed on both sides to narrow the distance

Several speakers addressed the critical need for both citizens and leaders in the United States and China to better understand one another, in order to widen the space for future cooperation. Fallows suggested, for instance, that journalists can play an important role as "intermediaries" between foreign policy practitioners and the general public, in "making Americans comfortable ... living with ambiguity" about China's future path.

Fallows and other conference speakers emphasized that one critical way of building greater familiarity between the United States and China is through day-to-day contact between the citizens of

both countries. Nelson Dong noted, for instance, that China sends more graduate students to the United States than any other country does – and that these students have become important figures for negotiating the different cultural and political perspectives of the two countries. Dong and Hills both pointed to the key role played by business communities in both countries in advocating for a stable bilateral relationship, and Hills argued that the U.S. business community needs to “speak publicly, much more than it is doing today, to employees, suppliers, and government leaders about the importance of the bilateral relationship.”

“It is ... beyond belief that we don’t understand the human factor so essential in building these bonds between businesses, and ... strengthening the relationships between the two countries.”

— Mr. Nelson Dong, Dorsey Whitney LLP

But, speakers asserted, governments must pave the way. For individual goodwill to translate into policy, trust must be built at the official level, through diplomatic activities such as high-level dialogues and military-to-military exchanges. Hills pointed to the key role played by regular meetings, such as the Strategic and Economic Dialogue and the Joint Commission on Commerce and Trade, in providing opportunities for U.S. and Chinese leaders to reach agreement and sometimes compromise on areas of common concern. Steinberg noted that, even though individual leaders in China are constrained in their freedom to act by

their collective, consensus-driven political process, the practice of maintaining frequent contacts between leaders has been very important in stabilizing U.S.-China relations and showing the commitment of both sides to keep the relationship moving forward.

Multilateral and regional institutions can act as important fora for countries to bring concerns and disputes before a neutral party. Hills noted that bringing trade disputes before the WTO “enables us to secure a neutral resolution of our differences, avoiding the build-up of animosity and the erosion of trust.” Ambassador Mirpuri highlighted the importance of a strong regional architecture in Southeast Asia, asserting that ASEAN and its associated bodies (such as the ASEAN Regional Forum and ASEAN Defense Ministers Meeting Plus), provide a “platform [of] a nonthreatening, friendly group of countries for the major powers to engage Southeast Asia as well as for the major powers to engage among themselves.”

Finally, several speakers noted that the U.S. leadership must itself take a sustained, active approach to its relations in Asia. Ambassador Mirpuri and Dr. Paal both noted that a key challenge faced by the United States in its relations with China, and in the Asian region more generally, is the perception that U.S. engagement in the region is sporadic, driven largely by domestic agendas. Paal characterized this approach as alternately “slamming on the gas and stepping on the brakes” – seeking a high level of interaction at times, and then pulling back as other national concerns take precedence. Mirpuri cautioned that this approach has caused many ASEAN nations to wonder whether U.S.

engagement in the region will be sustained over the longer term. Speakers agreed that smooth future relations between the United States, China, and the rest of the world must rest on the belief of all players that these relationships will persist over time.

Conclusion: What should we be watching for in the next stage of China's transition?

Now that the 18th Party Congress has concluded, the big questions are: Will China's new leadership undertake large-scale policy reform? If they do, how and when will we know?

Several speakers pointed to events at the Party Congress and beyond that could give outside observers some sense of the new leadership's views on the urgency of reform and the options available to them in undertaking reform, and of the likely content of any policy reform they choose to undertake. Such indicators would include:

- **The political report presented at the Party Congress.** This report is an authoritative Party document reflecting the top leadership's consensus on the Party's accomplishments over the previous five years, and setting out official guidelines for how to approach the Party's tasks in the upcoming five years. This will become the authoritative judgment on Hu Jintao's second term, and on the major policy tasks to be undertaken by Xi Jinping.
- **The leadership of the Central Military Commission (CMC).** At the 18th Party Congress, Hu Jintao stepped

down from his position as CMC chair – unlike his predecessor Jiang Zemin, who retained that position for two years after stepping down from his other official positions. This leaves the path clear for Xi Jinping, as the new CMC Chairman, to more fully take over the reins of military strategy.

- **The composition of the top military leadership.** The newly announced CMC, with four non-ground force military members – including a CMC Vice Chairman from the PLA Air Force – may indicate a diminishment in the traditional ground force domination of China's military. How this will translate into the PLA's understanding of national security missions, including prioritization of the maritime and aerospace domains, remains to be seen.
- **Reduction in the size of the Politburo Standing Committee.** Speakers suggested that the reduction to seven members from the previous nine means that, in theory at least, it may be easier for these members to reach consensus on key issues. A reduction or consolidation of the more conservative bureaucratic portfolios, such as propaganda or political and legal affairs, could indicate a more reformist agenda in the future.
- **Decision-making norms.** If the new leaders appear to jettison or downplay the consensus model of decision-making in the upcoming weeks and months, it could indicate that they are preparing to make more difficult policy choices.

- **Outcomes of the 2013 National People's Congress.** The final top-level turnover – that of PRC state organs – will not take place until next spring. While the NPC is often viewed as a rubber-stamp legislature, major laws are debated there, and top state leaders (particularly the Chinese Premier and members of the State Council) have key roles in economic policy. The content of the laws presented to the NPC, and the identity of the top state leaders, will be important in determining the policy orientation of these new leaders.
- **Public speeches and reports of the new leadership in the next one to three years.** If Xi Jinping is interested in changing the government's approach to economic growth, international relations, military strategy, or other major policy orientations, and if he follows the habits of his predecessors, he is likely to announce the new approach through speeches and papers presented to high-level military, state, and Party audiences.

"We are all going to try to incrementally see into the darkness, but recognizing how short the distances our headlights penetrate is the most important part of our policy."

— James Fallows, *The Atlantic*

Part II: Conference agenda

China on the Eve of the 18th Party Congress: What's at Stake?

September 12, 2012

8:00-9:00 Registration and Continental Breakfast

9:00-9:15 Welcoming Remarks and Introduction

Dr. David Finkelstein, Director of CNA China Studies

9:15-10:20 Session 1: What's at Stake for China?

9:15-9:20 Panel Introduction: Dr. Murray Scot Tanner
CNA China Studies

9:20-9:50 Speaker: Dr. Kenneth Lieberthal
Brookings Institution

9:50-10:05 Commentator: Dr. Alice Miller
Hoover Institution

10:05-10:20 Q & A

10:20-11:25 Session 2: What's at Stake for U.S.-China Relations?

10:20-10:25 Panel Introduction: Dr. David Finkelstein
CNA China Studies

10:25-10:55 Speaker: Mr. James B. Steinberg
Maxwell School of Syracuse University

10:55-11:10 Commentator: Dr. Alison Kaufman
CNA China Studies

11:10-11:25 Q & A

11:25-11:45 Break

11:45-1:10 Lunch

11:45-12:15 Speaker: Mr. James Fallows
The Atlantic

12:15-1:10 Lunch served

1:10-2:15 Session 3: What's at Stake for U.S. Business?

1:10-1:15	Panel Introduction:	Dr. Jeffrey Becker CNA China Studies
1:15-1:45	Speaker:	Ambassador Carla A. Hills Hills & Company
1:45-2:00	Commentator:	Mr. Nelson Dong Dorsey & Whitney LLP
2:00-2:15	Q & A	

2:15-2:30 Break

2:30-3:35 Session 4: What's at Stake for the Region?

2:30-2:35	Panel Introduction:	Dr. Thomas Bickford CNA China Studies
2:35-3:05	Speaker:	Ambassador Ashok Mirpuri Embassy of the Republic of Singapore, Washington, D.C.
3:05-3:20	Commentator:	Dr. Douglas H. Paal Carnegie Endowment for International Peace
3:20-3:35	Q & A	
4:00	Closing Remarks	Dr. David Finkelstein, Director of CNA China Studies

Part III: Speaker biographies

Session 1: What's at Stake for China?

Kenneth Lieberthal is Senior Fellow in Foreign Policy and in Global Economy and Development and also the John L. Thornton China Center at the Brookings Institution. He served as Director of the China Center for July 2009-August 2012. He is Professor Emeritus at the University of Michigan, where until 2009 he was Arthur F. Thurnau Professor of Political Science and William Davidson Professor of Business Administration. He earlier taught at Swarthmore College for 1972-83. He has a B.A. from Dartmouth College, and two M.A.'s and a Ph.D. in Political Science from Columbia University.

Dr. Lieberthal served as Special Assistant to the President for National Security Affairs and Senior Director for Asia on the National Security Council from August 1998 to October 2000. His government responsibilities encompassed American policy toward all issues involving Northeast, East, and Southeast Asia. Dr. Lieberthal was a Visiting Fellow in Foreign Policy Studies at Brookings for November-December 2000 and for the 2004-2005 and 2008-2009 academic years.

Dr. Lieberthal has written and edited twenty-four books and monographs and authored about seventy-five articles and chapters in books. His books and monographs include, *inter alia*: *Bending History: Barack Obama's Foreign Policy*, with Martin Indyk and Michael O'Hanlon (Brookings Press, 2012); *Addressing U.S.-China Strategic Distrust*, with Wang Jisi (Brookings, 2012); *Cybersecurity and U.S.-China Relations*, with Peter Singer (Brookings, 2012); *Managing the China Challenge: How to Achieve Corporate Success in the People's Republic* (Brookings Press, 2011); Contributing co-editor, *Chinese Politics: New Sources, Methods, and Field Strategies* (Cambridge: Cambridge University Press, 2010); *The U.S. Intelligence Community and Foreign Policy: Getting Analysis Right* (Brookings, 2009); *Overcoming Obstacles to U.S.-China Cooperation on Climate Change*, with David Sandalow (Brookings, 2009); and *Governing China: From Revolution Through Reform* (W.W. Norton, second revised edition 2004) -- Chinese translation published by the Chinese Academy of Social Sciences Press in January 2010. His recent articles include, *inter alia*: "Scoring Obama's Foreign Policy" (with Martin Indyk and Michael O'Hanlon), *Foreign Policy* (May/June 2012); "Lessons of the 40 years since Nixon went to China," CNN.com (February 21, 2012); "The U.S. and China Need to Show a Little Mutual Restraint," (with Stapleton Roy) *Washington Post* (February 10, 2012); and "The American Pivot to Asia," FP.com (December 21, 2011).

Professor Lieberthal was Director of Michigan's Center for Chinese Studies for 1986-89. He has consulted widely on Chinese and Asian affairs and has served as a consultant for the U.S. Departments of State, Defense, and Commerce, the World Bank, the Kettering Foundation, the

Aspen Institute, the United Nations Association and corporations in the private sector. He is a member of the Council on Foreign Relations in New York and the Cosmos Club in Washington.

Dr. Lieberthal is Senior Director of the Albright-Stonebridge Group and serves or has served as a member of the Boards of Directors/Advisors of the National Committee on U.S.-China Relations (and its Executive Committee), the East West Center, the U.S.-China Policy Foundation, the National Bureau of Asian Research, the U.S. Advisory Board of the Council on East Asian Affairs (Seoul), Tsinghua University's Center for China in the World Economy, the Research Center for Contemporary China at Peking University, the Shanghai Institute of Strategic Studies, the CSIS-IIE China Futures Initiative, the Asian Studies Visiting Committee at Harvard University, the East Asian Institute of the National University of Singapore, the William Davidson Institute, The Pyle Center, the Forum on Northeast Asia Security of the National Committee on American Foreign Policy, the China Vitae web site, and as Fellow of the Beijing University Political Development and Government Management Research Institute, Honorary Senior Fellow of the Institute of American Studies of the Chinese Academy of Social Sciences, and Guest Professor of the Chinese Academy of Governance. He serves on the editorial boards of *Asia Policy*, *China: An International Journal*, *The China Quarterly*, *The China Economic Review*, *Foreign Policy Bulletin*, and the *Journal of Contemporary China*. In 2004 he received the University of Michigan's Distinguished Faculty Achievement Award. For 2004-2007 he served on the Department of Defense Joint Strategy Review Senior Review Panel.

Dr. Lieberthal's wife, Jane Lindsay Lieberthal, is a former University administrator. He has two sons: Keith and Geoffrey.

Alice Lyman Miller is a research fellow at the Hoover Institution and teaches in the Departments of History and Political Science at Stanford. She is also a senior lecturer in the Department of National Security Affairs at the U.S. Naval Postgraduate School in Monterey, California.

Prior to coming to Stanford in 1999, Miller taught at the School of Advanced International Studies (SAIS) at Johns Hopkins University in Washington, D.C. from 1980-2000. From 1974-90, Miller worked in the Central Intelligence Agency as a senior analyst in Chinese foreign policy and domestic politics, and branch and division chief, supervising analysis on China, North Korea, Indochina, and Soviet policy in East Asia. Miller has lived and worked in Taiwan, Japan, and the PRC, and she speaks Mandarin Chinese.

Miller's research focuses on foreign policy and domestic politics issues in China and on the international relations of East Asia. She is editor and contributor to the Hoover Institution's

China Leadership Monitor, which offers online authoritative assessments of trends in Chinese leadership politics and policy to American policymakers and the general public. Miller has published extensively on policy issues dealing with China, including several articles and book chapters, as well as two books: *Science and Dissent in Post-Mao China: The Politics of Knowledge* (University of Washington Press, 1996), and, with Richard Wich, *Becoming Asia: Change and Continuity in Asian International Relations Since World War II* (Stanford University Press, 2011). She is currently working on a new book, tentatively entitled *The Evolution of Chinese Grand Strategy, 1550–Present*, that brings a historical perspective to bear on China's rise in the contemporary international order.

Miller graduated from Princeton University in 1966, receiving a B.A. in Oriental Studies. She earned an M.A. and a Ph.D. in history from George Washington University in 1969 and 1974. Formerly H. Lyman Miller, she transitioned in 2006.

Murray Scot Tanner (Scot) is an Asia analyst in the China Strategic Issues Group. Dr. Tanner has written and published widely on Chinese and East Asian politics and security issues, including internal security, social unrest, policing, and political reform in China, as well as China's emerging national security interests and policy-making institutions, Chinese military doctrine, and China's security relations with India, Russia, North Korea, and Taiwan. He is the author of many books, monographs, and articles, including *Distracted Antagonists, Wary Partners: China and India Assess their Security Relations* (CNA, 2011); *China Confronts Afghan Drugs: Law Enforcement Views of the 'Golden Crescent'* (CNA, 2011); *Chinese Economic Coercion Against Taiwan: A Tricky Weapon to Use* (RAND, 2007) and *The Politics of Lawmaking in China* (Oxford University Press, 1998). He is also co-author of *A Question of Balance: Political Context and Military Aspects of the China-Taiwan Dispute* (RAND, 2009), and *Chinese Responses to U.S. Military Transformation and Implications for the Department Of Defense* (RAND, 2007). His articles and book chapters, which have appeared in such journals as *The Washington Quarterly*, *Comparative Politics*, *The China Quarterly*, and *The China Journal*, include "Principals and Secret Agents: Central versus Local Control Over Policing and Obstacles to 'Rule of Law' in China" (*The China Quarterly*, September 2007), and "The Missions of the People's Liberation Army Air Force," (forthcoming, 2012).

Before joining CNA in 2008, Dr. Tanner served as professor of political science at Western Michigan University, as senior political scientist at the RAND Corporation, and as the co-chairman's senior staff member for the Congressional-Executive Commission on China. Dr. Tanner received his B.A. and Ph.D. from the University of Michigan.

Session 2: What's at Stake for U.S.-China Relations?

James Steinberg is Dean of the Maxwell School, Syracuse University and University Professor of Social Science, International Affairs and Law. Prior to becoming Dean on July 1, 2011, he served as Deputy Secretary of State, serving as the principal Deputy to Secretary Clinton. From 2005-2008 Steinberg was Dean of the Lyndon B. Johnson School of Public Affairs. From 2001 to 2005, Mr. Steinberg was vice president and director of Foreign Policy Studies at the Brookings Institution, where he supervised a wide-ranging research program on U.S. foreign policy. Mr. Steinberg served as deputy national security advisor to President Clinton from 1996 to 2000. During that period he also served as the president's personal representative to the 1998 and 1999 G-8 summits. Prior to becoming deputy national security advisor, Mr. Steinberg served as director of the State Department's policy planning staff, and as deputy assistant secretary for analysis in the bureau of Intelligence and Research. Previously, Mr. Steinberg was Senator Edward Kennedy's principal aide for the Senate Armed Services Committee and minority counsel, U.S. Senate Labor and Human Resources Committee. Mr. Steinberg's most recent book is *Difficult Transitions: Foreign Policy Troubles at the Outset of Presidential Power* (2008) with Kurt Campbell. Mr. Steinberg received his B.A. from Harvard and a J.D. from Yale Law School. His wife, Sherburne Abbott, is vice president for sustainability initiatives and University Professor of Sustainability Science and Policy at Syracuse University.

Alison Kaufman is an Asia analyst in CNA's China Studies division, where she has worked on issues related to China's and Taiwan's military culture, Chinese foreign and security policy, and cross-Strait relations. Prior to joining CNA, she worked for the World Bank's China program and at China Radio International in Beijing. She has also worked as a subject matter expert on Chinese affairs for a well-known consultancy. She has studied in Beijing and Taipei.

Dr. Kaufman received her B.A. in East Asian Studies from Harvard University, and her Ph.D. in Political Science from the University of California, Berkeley, with a focus on Chinese political philosophy. Her research interests include Chinese foreign policy, U.S.-China relations, Chinese nationalism, and cross-Strait issues. She has published work on the historical roots of current-day Chinese foreign policy, including "The 'Century of Humiliation,' Then and Now: Chinese Perceptions of the International Order" in *Pacific Focus* (April 2010).

David M. Finkelstein, a vice president at CNA, is the Director of CNA China Studies. He received his Ph.D. in Chinese history from Princeton University and studied Mandarin at Nankai University in Tianjin, China. As a long-time student of Chinese and Asian affairs, he is widely published. His 1993 historical monograph, *From Abandonment to Salvation: Washington's Taiwan Dilemma, 1949-50* (GMU Press), was hailed in *Presidential Studies Quarterly* as “blazing a new trail” and as certain to “take an important place in the literature of U.S.-China relations in the mid-20th Century.”

Dr. Finkelstein is co-editor of *China's Leadership in the 21st Century: The Rise of the Fourth Generation* (M.E. Sharpe, 2002), *Chinese Warfighting: The PLA Experience Since 1949* (M.E. Sharpe, 2003), *China's Revolution in Doctrinal Affairs: Recent Trends in the Operational Art of the Chinese People's Liberation Army* (CNA, 2005), and *Civil-Military Relations in Today's China: Swimming in a New Sea* (M.E. Sharpe, 2006).

A retired U.S. Army officer, Dr. Finkelstein is a graduate of the United States Military Academy at West Point, the U.S. Army Command & General Staff College, and the Army War College. He has held command and staff positions at the platoon, company, battalion, and major Army command levels. He has also held significant China-related positions at the Pentagon as an advisor to the Secretary of Defense and Chairman of the Joint Chiefs of Staff. In addition, he has served on the faculty at West Point, where he taught Chinese history.

Lunch Speaker

James Fallows is based in Washington as a national correspondent for *The Atlantic*. He has worked for the magazine for nearly 30 years and in that time has also lived in Seattle, Berkeley, Austin, Tokyo, Kuala Lumpur, Shanghai, and Beijing. He was raised in Redlands, California, received his undergraduate degree in American history and literature from Harvard, and received a graduate degree in economics from Oxford as a Rhodes scholar. In addition to working for *The Atlantic*, he has spent two years as chief White House speechwriter for Jimmy Carter, two years as the editor of *U.S. News & World Report*, and six months as a program designer at Microsoft. He is an instrument-rated private pilot. He is also now the chair in U.S. media at the U.S. Studies Centre at the University of Sydney, in Australia.

Fallows has been a finalist for the National Magazine Award five times and has won once; he has also won the American Book Award for nonfiction and a N.Y. Emmy award for the documentary series *Doing Business in China*. He was the founding chairman of the New America Foundation. His two most recent books, *Blind Into Baghdad* (2006) and *Postcards From Tomorrow Square* (2009), are based on his writings for *The Atlantic*. His latest book,

China Airborne, was published in early May. He is married to Deborah Fallows, author of the recent book *Dreaming in Chinese*. They have two married sons.

Session 3: What's at Stake for U.S. Business?

Carla A. Hills is Chairman and Chief Executive Officer of Hills & Company, International Consultants, which advises companies on global trade and investment issues, particularly in the emerging markets.

Ambassador Hills served as U.S. Trade Representative (1989-93), in which capacity she was President Bush's principal advisor on international trade policy.

Ambassador Hills served as Secretary of the U.S. Department of Housing and Urban Development in the Ford Administration. From 1974-75, she was Assistant Attorney General, Civil Division, U.S. Department of Justice.

Ambassador Hills serves on a number of corporate boards. She is Vice Chair of the National Committee on U.S.-China Relations, the U.S.-China Business Council, and the Inter-American Dialogue; Trustee of the Council on Foreign Relations and the Institute of International Economics; Member of the Board of the Asia Society; and a Member of the Trilateral Commission.

Ambassador Hills received her bachelor's degree from Stanford University, her law degree from Yale University, and has studied at Oxford University.

Nelson Dong is a partner in Dorsey's Corporate group, Chair of the National Security Law practice and co-Chair of the Asia-Pacific practice at Dorsey & Whitney LLP. He represents technology companies in venture capital financing, technology transfer and distribution agreements and other domestic and international technology and intellectual property transactions. He has substantial experience in counseling e-commerce, semiconductor, electronics, computer hardware and software, and biomedical and biotechnology companies with special expertise in domestic and international technology licensing, outsourcing and manufacturing in Asia and U.S. export control matters.

He has frequently written about intellectual property law, U.S. export control law, technology related business transactions between the U.S. and Asian or European countries, international strategic alliances, the Exxon-Florio law on foreign investments in U.S. technology companies, university-based technology transfer, academic

entrepreneurship, academic conflicts of interest and the financing and organization of high technology businesses. He has lectured on such topics throughout the United States and in Austria, Canada, England, the Netherlands, Hong Kong and the People's Republic of China.

Nelson was an Assistant U.S. Attorney in Boston (1980-82); Deputy Associate Attorney General, Department of Justice (1979-80); and White House Fellow and Special Assistant to U.S. Attorney General Griffin B. Bell, Department of Justice, Washington, D.C. (1978-79).

Jeffrey Becker is an Asia analyst in CNA's China Studies division. Prior to joining CNA, he was the China Director for an international nonprofit organization based in Washington DC. Dr. Becker has served as an adjunct professor at Penn State University and George Washington University, and has previously published research on Chinese labor politics, Chinese anti-corruption efforts, and CCP institutions.

Dr. Becker has lived and studied in China, and his research has appeared in *Comparative Political Studies*, edited volumes on Chinese politics, and the *Journal of Chinese Political Science*. His research interests include Chinese political economy, Chinese foreign affairs and security issues, and party and military institutions and organization. He received his B.A. in international relations and Asian studies from Colgate University, M.A. in political science from Columbia University, and Ph.D. in political science from George Washington University.

Session 4: What's at Stake for the Region?

Ashok Kumar Mirpuri took up his appointment as Singapore's Ambassador to the United States in July 2012. Before that, he was Singapore's Ambassador to Indonesia from 2006 to 2012, High Commissioner to Malaysia from 2002 to 2006 and High Commissioner to Australia from 2000 to 2002.

Mr. Mirpuri joined the Ministry of Foreign Affairs (MFA) in 1984. From 1987 to 1991, he was First Secretary (Political) at the Singapore Embassy in Jakarta. In 1994, he was appointed Director of MFA's Policy Planning & Analysis Directorate I (Southeast Asia). In 1997, Mr. Mirpuri was seconded to Shell International Ltd in the United Kingdom as Corporate Advisor (Asia Pacific). He returned to the Singapore Embassy in Jakarta in 1998 as Minister-Counsellor and Deputy Chief of Mission.

Mr. Mirpuri graduated with an honours degree in Political Science from the National University of Singapore. He received his MA at the University of London's School of Oriental & African Studies under a Raffles Scholarship. He did the Programme for Executive

Development at the Institute for Management Development in Lausanne, Switzerland, and attended the Advanced Management Program at Harvard Business School, USA.

Mr. Mirpuri was awarded the Public Administration Medal (Gold) by the Singapore Government in 2010.

Douglas Paal is currently Vice President for Studies at the Carnegie Endowment for International Peace. He previously served as Vice Chairman of JPMorgan Chase International from 2006 to 2008, and as the unofficial U.S. representative to Taiwan as Director of the American Institute in Taiwan from 2002 to 2006. He also served on the National Security Council staffs of President Reagan and George H.W. Bush between 1986 and 1993 as Director of Asian Affairs, and then as Senior Director and Special Assistant to the President. He held positions in the policy planning staff at the U.S. Department of State and at U.S. Embassies in Singapore and Beijing. Dr. Paal is the Founder and a former President of the Asia Pacific Policy Center, and served on the board of directors for ATC International. He received his A.B.-A.M. in Chinese Studies and Asian History from Brown University and his Ph.D. in History and East Asian Languages from Harvard University.

Thomas J. Bickford is an Asia analyst in CNA's China Studies division and currently focuses on Chinese maritime strategy, Chinese national security policy, and China's relations with its neighbors. His previous work includes several articles and book chapters on Chinese civil-military relations, professional military education, and internal security. Before joining CNA, he was an associate professor at the University of Wisconsin-Oshkosh, where he taught international relations and Chinese politics. He is also a former associate director of the Wisconsin Institute for Peace and Conflict Studies.

Dr. Bickford has lived and studied in Taiwan and Hong Kong, and has conducted extensive field research in China. He has a B.A. in East Asian studies from the University of Chicago, an M.S. in international studies from the London School of Economics, and a Ph.D. in political science from the University of California, Berkeley.

Part IV: Conference transcript

Welcoming remarks and introduction

Dr. David Finkelstein, Vice President, CNA China Studies

DR. DAVID FINKELSTEIN: Good morning, everybody. For those of you who may not know me, I am Dave Finkelstein, Director of China Studies at CNA, and welcome to our conference, "China on the Eve of the 18th Party Congress: What's at Stake?"

As you may already have guessed by some of the logos on the materials for the conference, CNA is also celebrating its 70th anniversary, and this conference is part of that celebration.

Our organization goes back to the first dark days of the Second World War when the War Department recruited a small group of scientists to help the United States Navy deal with the threat posed by German U-boats. And since 1942, CNA analysts have been in the forefront of providing analytic support to federal, state, and local government officials through its two divisions, the Center for Naval Analyses, a federally funded research and development center, and the Institute for Public Research.

And in addition to supporting our sponsors, we take great pride, on occasion, in informing the public discourse and debate, as we are today, on important issues, on defense, security, foreign policy, education, public health, the environment, and a host of other issues that are of importance to leaders in government, leaders in business, and the public at large.



DR. DAVID FINKELSTEIN, CNA China Studies

The handful of scientists who comprised that first analytic group of CNA in 1942 would probably be surprised to learn that today, CNA has over 300 analysts, both at our headquarters in Alexandria, Virginia, and deployed to over 50 locations around the world. They would undoubtedly be surprised to learn that CNA has a thriving China Studies program with a little under two dozen analysts as of this week, all of whom have lived, worked, or studied in Greater China, and all of whom speak Mandarin. And some of them are here today, and I hope you have a chance to meet some of these talented rising stars in the China field.

So, with Secretary of State Clinton just in China last week and of course Defense Secretary Panetta about to go next week to Beijing, the timing of this conference couldn't be better. But even without the current flurry of diplomatic activity between Beijing and Washington, convening to discuss the upcoming 18th Party Congress would still be high on our agenda because of the number of top leadership positions that we know are probably going to change out in Beijing. And we all know the litany, but for those of you who aren't following the baseball scorecard, we do know that CCP General Secretary Hu Jintao will step down and, by most accounts, be replaced by Xi Jinping, thus ushering in the era of the fifth generation of leadership.

The Politburo Standing Committee, the center of gravity of collective leadership in China, will probably replace seven of its nine members, and rumors abound, even as we speak, that this body may be reduced from nine to seven members. We shall see.

It's also likely that 14 members of the current full Politburo will be replaced, and on the Central Military Commission, the equivalent of the National Command Authority in China, 7 out of 10 of the current generals should be in line to retire and be replaced. A new 18th Central Committee will be established, and some informed analysts, such as my colleague Cheng Li at Brookings, believe that up to 60 percent of the Central Committee will turn over and be replaced. Additionally, leadership of several powerful internal CCP organs, such as the Central Discipline Inspection Commission or the Party Organization Department, may or may not change hands. We will wait and see. And, of course, China's political season will not end with the 18th Party Congress but will extend into the spring of 2013 when the National People's Congress convenes in order to change out state positions.

But beyond the personalities, the importance of the upcoming 18th Party Congress is also defined by the myriad issues that the new leadership is going to have to confront, both at home and abroad. And how China's new leaders will deal with their domestic and external challenges will have terrific implications, far beyond China's shores; hence the theme of today's conference, "What's at Stake?"

What's at stake for China itself? The incoming fifth-generation leaders will confront a daunting list of domestic problems: the rich-poor gap, the urban-rural divide, East-West development imbalances. They'll have to deal with terrible environmental degradation and the associated issues of water and food security. They're going to confront the tyranny of demographics and the "graying" of China and the need for a much better social safety net, and, of course, there is the issue of sustaining economic growth in the midst of a global economic turndown and the pressing need, of course, for economic rebalancing.

Overall, when Hu Jintao wakes up in a cold sweat in the middle of the night, I don't believe it's Taiwan reunification he's worried about, but rather how to create jobs, social stability, and keep the regime moving forward.

To help us navigate the complex issues the new leadership will face, we are lucky to have with us today Ken Lieberthal of the Brookings Institution and Alice Miller of the Hoover Institution. If there were such thing as an American Olympic team put together to analyze

Chinese domestic politics, Ken and Alice would be the co-captains. I have learned much from both of them over the years, and I am absolutely delighted, on a personal and professional level, that they decided to participate in today's conference.

"What's at Stake for U.S.-China relations" is our second panel. As underscored by Secretary of State Clinton's visit to Beijing last week, the U.S.-China relationship continues to defy simple characterization. It will continue to be a relationship comprising a very tangled and messy web of issues that, on the one hand, impel and compel the U.S. and China to cooperate on a host of issues out of sheer national self-interest while, on the other hand, it is a relationship that will continue to be characterized by issues of contention, depending on various issues at stake.

If you were to go down a list of current U.S. security interests, you would probably find that there is a China factor associated with many of them: Pakistan, North Korea, Iran, Syria, nuclear proliferation, climate change and clean energy, the Global Commons, space, cyberspace, and the maritime domain. Each obviously has an associated China factor.

And I think the same can be said of China. Beijing continues to grapple with the ubiquitous "America" factor in many of its most important security concerns, all of which reminds us that in our hyper-globalized world, you don't get to choose your dance partner. These days, your dance partner is chosen for you.

So we are absolutely delighted to have with us today, to help us navigate the issues of U.S.-China relations for the new party leadership, Jim Steinberg, who is currently Dean of the Maxwell School at Syracuse University. He is going to provide his views on the importance of the upcoming Party Congress to U.S.-China relations. And, of course, up until very recently, as Deputy Secretary of State, he was – to borrow the title from Dean Acheson's memoirs – "present at the creation" of this current administration's policy toward China and toward Asia writ large. And so it's terrific to have him here. He will be showing up in just a little bit. I appreciate the demands on his time, especially at the beginning of a new semester up at Syracuse.

Now, serving as a commentator on this panel will be CNA's own Dr. Alison Kaufman, who is one of our rising stars in the field of China political analysis. Alison has just returned to CNA from a year-long post-doctoral fellowship at Harvard.

Thank you, Alison, for taking on this mission, even before you unpacked your books to move back into your office.

"What's at Stake for U.S. Business?" The business dimensions of the U.S.-China relationship are a critical component of this complex bilateral relationship, and the views and equities of the U.S. business community have traditionally been an important factor in the Washington-Beijing dynamic.

The most recent white paper produced by the American Chamber of Commerce in Beijing, AmCham China, points to a series of enduring challenges to the business climate in China

that many U.S. business leaders hope the new Chinese leadership will address. That white paper also addresses new opportunities for American businesses.

Now, among the challenges is the fact that the regulatory environment in key business sectors in China has not kept up the pace with the realities and requirements on the ground. Among the opportunities is the fact that, according to some, economic structural reform is slowly taking place already. We can debate that later.

But what is the state of play for American business interests on the eve of the 18th Party Congress? What are U.S. business leaders hoping to see change? What are the prospects for change? To help us with these fundamental issues, we are very fortunate to have with us Carla Hills and Nelson Dong.

Ambassador Hills brings to this topic a unique blend of China experience and insights from both the private sector and from government. A former U.S. Trade Representative and the current Chair of the National Committee on U.S.-China Relations, she brings to this discussion not only informed views on business relations with China, but U.S.-China relations writ large. Thank you for gracing us again.

We are also delighted – and I am personally delighted – to have on this panel, Nelson Dong of Dorsey Whitney, LLC, where he is chair of the National Security Law Practice and co-chair of the Asia Pacific Practice. A former White House fellow and active member of the Committee of 100, he brings a practitioner's special insights into the issues of intellectual property rights, technology transactions, and export control matters. He is also a friend of CNA China Studies, and I'm grateful that he flew out today from Seattle to be with us. He has an incredibly busy schedule.

Finally, "What's at Stake for the Region?" Clearly, as an international actor of consequence, the results of China's Party Congress will attract attention internationally, but it's in China's neighborhood in particular, in Asia, where the stakes will be unquestionably the greatest and where foreign attention will be most focused.

To provide a regional perspective on what's at stake for the region as China undergoes its political season, it is our high privilege to have with us later on today His Excellency Ashok Kumar Mirpuri, who, as of July 12th, arrived in Washington as Singapore's new Ambassador to the United States.

Ambassador Mirpuri comes to the U.S. from Jakarta, where he was Ambassador, and he brings with him a wealth of experience in his own right throughout Southeast Asia, Europe, and beyond. And I believe this is Ambassador Mirpuri's first public speaking engagement since arriving here in Washington, so we are absolutely delighted that he and the government of Singapore has acceded to our request to have him bring this important regional voice to this particular conference so it's not just American voices.

To support that panel, we're also going to have Douglas Paal of the Carnegie Endowment for International Peace. Doug is both a China expert as well as an Asia regionalist, and he

brings to the table a remarkable set of professional experiences in Asia as a government official, a scholar, and a businessman. He's worked the region from the White House, from our embassies in Beijing and Singapore, and as director of the American Institute in Taiwan. And in a field where most analysts are narrowly focused specialists, few have Doug's breadth of and depth of perspective. And I thank him for participating in this.

Now, last but certainly not least, we will have as our pre-luncheon speaker James Fallows, the national correspondent for *The Atlantic*. Among the myriad important topics he covers, Jim has been following Asian and Chinese affairs for many years. I first became a fan of his work on Asian affairs back in 1995, when he published *Looking at the Sun: The Rise of the New East Asian Economic and Political System*. And, given his recent tour in China, both in Beijing and Shanghai, and the publication of his latest book, *China Airborne*, Jim is undoubtedly going to provide some unique insights to today's gathering.

So thank you, everybody, for being with us today. Thanks to the many friends of CNA China Studies who comprise this extremely well-informed audience of specialists. To our colleagues in the U.S. government, we say thank you for the continued confidence you place in our analyses to support you. To our colleagues from other institutes who are here today – Carnegie, Brookings, CSIS, NBR IDA and others – we thank you for many years of collegiality and collaboration.

We welcome members of the diplomatic corps, embassies of China, Cambodia, Vietnam, Japan, others that I may have missed.

And our thanks, as ever, go to our CEO, Bob Murray, who for many years has supported our China program in many tangible and just as many intangible ways. Thank you, Bob, for making this program possible over so many years.

And, finally, my deepest personal thanks to Tamara Hemphill, our long-suffering but extremely effective division program director, who is the evil genius behind anything that goes right today. Without her, none of this would have been able to happen.

So thank you, everybody, for coming today, and we're just a little bit over time, but that's good. We can go ahead and start that first panel right now. Thank you.

[Applause.]

Session 1: What's at stake for China?

Panel introduction: Dr. Murray Scot Tanner, CNA China Studies

DR. MURRAY SCOT TANNER: Good morning. I am Murray Scot Tanner, Senior Research Scientist in the China Studies Division at CNA, and it is my privilege this morning to chair the first panel.

In a couple of weeks, or perhaps a little longer, the Chinese Communist Party will be handing over to a new set of leaders the institutional leadership of the party, and then the following spring of the state organs of power. That new leadership is going to face not only an enduring set of daunting challenges but also a whole new series of additional problems on their agenda, the result of many years of successful economic development and other changes in China.

The list is daunting: how to sustain economic growth, how to continue to confront poverty and inequality in China, and how to deal with a vast Chinese bureaucracy and the problems of keeping control over both central and local officials. Also added to that list: there is an array of new policy actors that have entered the Chinese system in the last decade or so, the question of how to institutionalize or reinstitutionalize relations between the Chinese state and an increasingly restive population, the problems of dealing with political reform, the problems of dealing with predation, corruption, environmental degradation; and also a whole new series of problems that result from dealing with a China whose global footprint during the Hu Jintao era expanded enormously – with millions of Chinese now living and working overseas, in many cases some of the most unstable countries in the world, with billions of dollars of Chinese investment in other projects.

I recall a number of years ago when I was a professor, listing off all the various things that the Chinese leadership had to deal with for my students, and at the end of it, one of my students raised their hand and said, "You know, you spend a lot of time talking with us about who is going to lead China and how they're going to lead China in the future. You never address for us the question of why anybody would *want* to lead China, dealing with this list of problems."

We've asked our panel, what is at stake for China in the upcoming 18th Party Congress transition, to



DR. KENNETH LIEBERTHAL, Brookings Institution

DR. MURRAY SCOT TANNER, CNA China Studies

DR. ALICE MILLER, Hoover Institution

highlight some of the most pressing issues and challenges in domestic and foreign policy that the fifth-generation leaders are going to face: the socioeconomic challenges, domestic governance and political structure problems, foreign policy and security challenges. And to do this, we are blessed to have with us today two of the most experienced and thoughtful analysts of the modern Chinese political system. Dr. Ken Lieberthal is Senior Fellow in Foreign Policy and Global Economy and Development and at the John L. Thornton China Center at the Brookings Institution. He was the director of that center from July 2009 until just this past August. He is also Professor Emeritus at the University of Michigan.

From August 1998 to October 2000, he served as Special Assistant to the President for National Security Affairs and as Senior Director for Asia. His list of publications, as is true with Alice, is far too long to be read here. But I would note in particular, among his recent publications, he's co-author of *Bending History: Barack Obama's Foreign Policy*, and one long essay or report co-authored with Wang Jisi that I recommend to everybody in this room, *Addressing U.S.-China Strategic Distrust*.

Dr. Alice Miller is Research Fellow at the Hoover Institution and teaches in the Departments of History and Political Science at Stanford University. She is also Senior Lecturer in the Department of National Security Affairs at the U.S. Naval Postgraduate School in Monterey. She is the editor of Hoover Institution's widely regarded *China Leadership Monitor*, required reading for many of us; and author of *Becoming Asia: Change and Continuity in Asian International Relations Since World II*, and a forthcoming book with the extraordinarily ambitious title of *The Evolution of Chinese Grand Strategy: 1550 to the Present*.

We appreciate their willingness to take time to talk with us this morning and thank them very much. I'll turn things over to Ken.

Speaker: Dr. Kenneth Lieberthal, Brookings Institution

Takeaways – Dr. Kenneth Lieberthal

- The new leaders named at the 18th Party Congress will inherit a China that is at a breaking point, economically and socially.
- China's very successful development model has now largely run its course, and the costs of not shifting to a new model are rapidly rising.
- The current model of economic development faces five major obstacles: demographic pressures, slow global growth, environmental degradation, corruption, and diffusion of authority.
- China's consensus-based model of decision-making is likely to hamper any major reform efforts.
- The 18th Party Congress offers the opportunity to get China out of a “leadership rut” and start reforms that are critical to China's sustaining social stability and economic growth.

DR. KENNETH LIEBERTHAL: Thank you very much, Scot. It's really a pleasure to be here today. Your introduction does make me wonder what happened in 1549 that I should know about but don't.

[Laughter.]

DR. KENNETH LIEBERTHAL: I've been asked to address the topic, "The 18th Party Congress: What's at Stake for China?"

On the way over here this morning, as I thought about it, I realized that you could sum up my remarks very simply. What's at stake for China is roughly what's at stake for the United States on November 6th, because the 18th Party Congress will produce the identification of the new leaders, those who will actually be in charge of exercising power. But they take over at an unusually critical time in their own country's evolution, because their country, as our country, faces a set of choices that will determine whether we are able to continue along the path that we have been on for a number of years or whether we, because of political failings largely, will trip ourselves up and get increasingly bogged down on our side by debt and on their side by a host of problems that I'll be discussing.

So the big issue is whether coming out of that Party Congress, the new leaders have the capacity, the political capacity, to make the decisions and implement the decisions to address the problems that they confront. I'll tease that out, but that's the nubbin of the issue. In a sense, both of us are in the same boat, and I would argue the outcome is equally undetermined in both countries. I'll now spend 25 minutes laying that out in more detail for you.

The one other comment I want to make before I get into my formal remarks is that the rest of this conference is on various aspects of China's international behavior or interaction with the rest of the world. My own strong belief over the course of my career has been that if you want to understand China's international behavior, you first have to understand its domestic affairs. And so I hope that the remarks that we hear on this panel this morning will help to inform the discussion of the other very important topics on the agenda for the rest of the day. With that, let me get into my formal remarks.

China's system obviously is huge and complex, and it's, frankly, full of elements that make bottom-line judgments extremely difficult about this country. Let me give you just four examples to highlight this.

This is a political system of enormous governing capacity, right? It is a capable political system in comparison with most other political systems and all of the developing country political systems in the world. But it also suffers from very serious political dysfunction: huge distortions of information, huge problems of agency, huge lack of accountability, huge disconnects between the system and the population that it governs, and so forth.

So you have this kind of anomaly of an extremely capable system and one that is, in many ways, performing way under what it should be doing if it carried out appropriate reforms that don't challenge the system but make it more effective.



DR. KENNETH LIEBERTHAL
Brookings Institution

Second, this is a system that has developed a very sophisticated path to high office. To get to the highest office, you have to have run at least one province. You have to have had time at the center. There is a very conscious career path that has been fostered with great efforts to make this a meritocratic system. You, generally speaking, have to deliver in each of your positions to move forward.

They do not allow peanut farmers to run for general secretary. Those of my generation know that's a Jimmy Carter reference.

[Laughter.]

DR. KENNETH LIEBERTHAL: And yet, at the same time, it is a system that is grossly corrupt and inward looking. It really affects the quality of the output of this political apparatus.

Third, we have massive urbanization in China. During the Hu Jintao administration, just over the last 10 years, officially the percentage of Chinese population that were categorized as urban went from about 37 percent to 51 percent, absolutely extraordinary when you look at the numbers concerned. But the reality is only 35 percent of those people are urban citizens. The rest are rural migrants who are still rural citizens – no access or very, very limited access to urban opportunities.

It's a bizarre situation, one where now somewhere north of 30 percent of all people living in cities are an underclass, a structural politically determined underclass. That's not a formula for stability. That's also not a formula for increasing domestic consumption because these people are very limited in what they can do.

It's also a country characterized by both the enormously, astonishingly rapid growth of the middle class, and at the same time one of the most rapid marches toward inequality of distribution of wealth that we have seen in modern history.

It's a bizarre situation, where somewhere north of 30 percent of all people living in cities are ... a structural, politically determined underclass. That's not a formula for stability.

So this is a place of contradictions, and it's not easy to get your hands around this and figure out what you want to say as net assessments of it. Having said that, I think there are some judgments that to me are both significant and can be made with confidence, so I want to shift my ground onto that territory.

The overall issue here, I believe, is that China's very successful development model – and, my god, it's been successful over the last three decades, beyond anyone's expectations three decades ago – that very successful development model has now largely run its course, and the costs of not shifting to a new model, a significantly different model, are very rapidly rising and they're very real.

That model has run its course largely, to my mind, because it was based on five assumptions, all of which are now largely untrue, all of which are now largely exhausted. Let me be explicit about each of them.

The former development model assumed, first of all, a virtually unlimited supply of flexible, young, cheap labor. But the 18-to-32 age bracket now in China is actually shrinking, and it will be shrinking at an accelerating rate over the coming two decades, so that China is undergoing now the most rapid transition in history, from having a demographic surplus – in other words, a larger number of people of working age, a smaller number of dependents either too young or too old to work – to the opposite, a demographic deficit, really having too few people in working-age brackets compared to the number of dependents, too young and too old. In China's case it is overwhelmingly too old.

The former development model assumed ... a virtually unlimited supply of flexible, young, cheap labor.

Many of the migrants in the cities, moreover, now have no agricultural experience. So while they are considered to be migrants, many of them were born in the city, have never done a day of agricultural labor in their lives, and yet cannot become urban citizens. And these people are demanding better working conditions, higher salaries, and more opportunities.

So all of this suggests that this notion of a virtually unlimited pool of cheap, flexible young labor is rapidly becoming a thing of the past, but the economy is built in part on the assumption that that is going to continue.

Secondly, the development model pursued to date has assumed that the international arena would be receptive to rapidly growing Chinese exports for many years into the future. That, until 2008, was a tough but not totally unrealistic assumption. In 2013 that is an unrealistic assumption, in part because of problems of growth of the modern industrial countries. Europe is now actually anticipating negative growth this year. Japan has shifted its growth forecast for the year from 0.3 percent to 0.2 percent. The United States has a weak positive growth trajectory, but if Europe should turn down sharply, it's not quite clear where we would head.

So the markets to which they want to sell simply are not growing at the rates that were anticipated. That has political consequences with increasing pressures for protectionism. And, to my mind, as we look forward here, the downside risks exceed the upside risks, given what we see in the papers every day.

The third assumption is that they had a capacity to follow other countries in that they could grow now and clean up later. And let's face it: all of us did that, and we're in various stages of clean up. But no currently developed country went through its critical stage of industrial

development with extraordinary environmental sensitivity. The reality, as Dave mentioned in passing, is that China's environmental devastation is now constraining economic growth and imposing high economic, social, and political costs.

The scarcity of usable water in north China is utterly startling. By international standards, a viable standard has 2,000 cubic meters of water available per person per year. The minimum necessary for a viable society is 1,000. North China, from Shanghai to Beijing, is now below 400. Beijing is well under 200.

The scarcity of usable water in north China is utterly startling. By international standards, a viable society has 2,000 cubic meters of water available per person per year. Two thousand is the key number. The minimum necessary for a viable society is 1,000. North China, from Shanghai to Beijing, is now below 400. Beijing is well under 200.

The water table is how far down you go before you hit water; under the entire North China plain it drops by 3 feet a year. Under Beijing, it drops by 12 feet a year.

Nearly forty-five percent of China's surface water, including the water that I'm referring to here, is so polluted that it cannot be treated to the point where it can be used for any purpose whatsoever.

This is truly a crisis, and they are beginning to take measures. By the way, this crisis also affects energy because China's biggest coal basin is in the north. Mining coal is very water-intensive, and they don't have the water to fully mine the coal at optimal levels in north China, and that constraint is growing.

There is also an epidemic of environmentally related health problems, such as asthma and other chronic respiratory ailments, also cancers and that kind of thing. There are cancer villages all over China.

This is now a situation where I am told privately by people in China's Ministry of Environmental Protection that about 20 percent of the mass incidents that you read about in China are now directly around environmental issues – you know, riots over chemical pollution of fields, etc.; this kind of thing is rampant. So it is now a significant challenge not only to economic development, to sustainability of Beijing as a capital city, but also to the social stability of the country.

About 20 percent of the mass incidents ... in China are now directly around environmental issues. ... So it is now a significant challenge not only to economic development ... but also to the social stability of the country.

Fourth assumption is that there would be sufficient popular tolerance for the growth of corruption and inequality as the necessary frictional costs of transitioning from a planned to a market system. And there is a lot of education that the government did over the years as to the unavoidability of these two types of problems. Simply, as you transition from plan to market, you don't have the necessary ethical and the regulatory systems and all of that kind of thing. So there's a problem there.

There is a great deal of evidence now of significant outflows of money from wealthy Chinese individuals because of two fears: fears of government depredation ... and fears of popular outrage and violence.

There is a great deal of evidence now of significant outflows of money from wealthy Chinese individuals because of two fears: fears of government depredation, that you will get on the wrong side of something and your wealth will disappear; and fears of popular outrage and violence. Most wealthy Chinese have bodyguards now. You talk to wealthy Chinese now about how secure they feel and they will give you a tale of woe that this place is no longer safe. It's very good for the real estate market in New York, by the way, but it's not good for China.

And corruption and inequality of wealth typically rank at or very near the top of the list of public concerns in almost every public opinion poll. So, that again is affecting this key issue of social stability and capacity to continue to move forward along current lines.

And then, finally, the former model assumed that the Chinese system would give the top leadership, especially the members of the Politburo Standing Committee, the power and autonomy to take a national perspective, to make well-informed decisions in the national

interest, and to implement those decisions in a reasonably high-quality fashion. In reality, that is no longer the case. Part of this is carrying forward a system that has worked before but with some significant modifications that make it less effective.

If you look at the Politburo Standing Committee – as I think Dave mentioned before, there are nine members to the committee now; it may get reduced to seven in the future. There is a division of responsibility among them, so that each member heads a major system, whether it's political and legal affairs, or propaganda and education, or finance and economics, or party organization, or whatever it may be, but there is a quite clear division of responsibility among them, which means, effectively, that each of them comes to represent a huge bureaucratic, and in many cases economic, set of interests on the Politburo Standing Committee.

That's fine. They've always done that. That's a reasonable way to handle things. The problem is that with the Hu Jintao administration, they have really deeply embedded a norm of consensus decision making, so that this is not even a majority vote system. If there are one or two standing committee members who very strongly object to a decision being made, Hu's practice has been to table the decision, not take it up until you can get a consensus, or at most one outlier there.

Well, when you've got people representing major vested interests and you have an ability to move forward only if you can truly get a consensus, not surprisingly you cannot get a consensus that undercuts seriously the interests of any of those major areas of responsibility.

So what kind of consensus can you get? You can get a consensus to spend more money. If you've got a problem, you increase the budget to deal with that problem and have some new programs to deal with the problem. Happy to vote for your program because you're going to vote for my program, and we're doing pretty well financially.

And if you look back at the last 10 years, what really distinguishes it in many ways from the leadership before that, the Jiang Zemin, Zhu Rongji leadership – not even going back to Deng Xiaoping – is that the Jiang-Zhu leadership pushed through major structural reforms of the system.

The Hu Jintao leadership has spent a lot of money addressing real problems but has pushed through virtually no structural reforms of the system, because they can't get a consensus in favor of structural reform. They can get a consensus in terms of spreading the wealth among the major players here.

When you've got people representing major vested interests and you have an ability to move forward only if you can truly get a consensus, ... you cannot get a consensus that undercuts seriously the interests of any of those major areas of responsibility. ... You can [only] get a consensus to spend more money.

There are two types of interest groups here that are very, very powerful. One is local leaders. By "local" I mean everything from province to city to county to township. The key territorial leaders at each of those levels are numerous: there are thirty-one provinces, over 650 cities, more than 2,500 counties, and several tens of thousands of townships. The leaders in each of those jurisdictions have enormous authority within their own bailiwick. They are given a great deal of flexibility as to how they will, in fact, act within that bailiwick so long as they then can meet three criteria.

One is to make their GDP grow every single year, probably the most important single criterion. And the other two are things you have to avoid. There can be no major mass incidents in your bailiwick that year – such an incident is very bad for your career. And there should be no incidents that embarrass the system as whole – major product safety scandal, melamine in the milk or whatever it is – that makes the system look bad coming out of your bailiwick that year.

And at the end of the day, if you can meet those three criteria, you're going to do well. By the way, your family will do very well, too, because this is a system that enables you and your family to participate in the wealth that you're generating in your locality. And you get the opportunity to move up to the next higher level, govern a larger economy and do even better.

Those incentives naturally lead to prioritizing infrastructure development and real estate development and manufacturing. These are things that produce not only jobs and that kind of thing and add to GDP growth, they also produce big flows of money. It's nice if there's a big pot of money coming down the pike – everyone can benefit from that in one way or another.

So the incentives here are the right incentives for the former model but are the wrong incentives for a model where you want to grow the service sector, where you want to get into higher quality, the higher value-added end of the manufacturing sector, more innovation and that kind of thing, and where you want to play down infrastructure development. You've thus got a huge problem in that you can throw money at problems from the center but as it filters down through the system, the money gets reallocated and spent in ways that were prioritized by the development model that they've been following to date.

Secondly, there are powerful corporate interests now in China, and those corporate interests in many cases are tied directly to elite families. This is really a marriage of wealth and power. And this has created a situation in which the capacity to address corruption is very limited, given the family activities of most elites. Now, Beijing recognizes all of this,

There are two types of interest groups in China that are very powerful. One is local leaders, [who] are given a great deal of flexibility as to how they will act within their bailiwick as long as they can grow their GDP, have no major mass incidents, and have no incidents that embarrass the system as a whole. ... [The second] is powerful corporate interests, which in many cases are tied directly to elite families.

obviously, but it has recognized it for quite a while and it has not, to date, made the changes necessary to improve things significantly.

What is at stake for China, put simply, with the 18th Party Congress, therefore, is whether the Party Congress will put in place both the leadership and, over time, the systemic capacity to shift to the new development model that we saw adopted more than a year ago in the 12th Five-Year Plan, a model more driven by domestic consumption, less driven by investment, less driven by exports, more higher value-added, less resource intensive manufacturing, et cetera, et cetera.

Much of that model was reflected in the jointly authored World Bank/State Council Development Research Center report that came out this past spring looking to China in the year 2030, but indicating what it had to do to get there in pretty good shape. And it was, effectively, adopt a new development model and make it actually work.

What is at stake for China with the 18th Party Congress is whether [it] will put in place both the leadership and, over time, the systemic capacity to shift to the new development model that we saw adopted more than a year ago in the 12th Five Year Plan, a model more driven by domestic consumption, less driven by investment, less driven by exports, more higher value-added, less resource intensive manufacturing.

That report was very authoritative in that, in China, Li Keqiang, the incoming premier, presumably, directly supported doing the work, and the people at the Development Research Council who actually participated in this were some of the key people in the finance and economic sector in China.

Indicative of the difficulties of making that transition is the fact that after this report was published, the SASAC website – SASAC is the organization that actually formally owns all of the central-level state-owned enterprises. It's a very, very powerful organization. That website directly criticized the report.

I heard at a private dinner in Beijing about four weeks ago a minister, who was at my table, tear the report to shreds. What he said was this was – and I'm quoting here on the adjectives – "naïve, wrong-headed, and an embarrassment." And this report was widely known to be supported by the incoming premier.

Let me turn to the 18th Party Congress itself. We're in that period where there are many straws in the wind, including the key question of the day: where is Xi Jinping?

[Laughter.]

DR. KENNETH LIEBERTHAL: Seriously, there are a lot of straws in the wind. All of us who work with China are quietly being given lists of Politburo Standing Committee members – how many, who they will be, who's in contest for this or that, and so forth. We've all been through this before. Alice knows this better than anyone here.

Obviously, 98 percent of those straws in the wind will prove in a few weeks to have been wrong. This is a time when strategically designed rumors proliferate in Hong Kong media, in Beijing, et cetera. Therefore, I frankly don't pay much attention to the latest line-up because I've learned that more often than not it's simply part of a political game; it's not part of the reality that will emerge.

The 18th Party Congress ... will offer the opportunity to get China out of the leadership rut that it has been in and create the possibility of starting reforms that are critical to China's sustaining social stability, economic growth, and a sense of national confidence.

I think perhaps the most important impact of the 18th Party Congress is simply that it will offer the opportunity to get China out of the leadership rut that it has been in, in recent years, and thus create the possibility – I stress "possibility" – of starting reforms that are critical to China's sustaining social stability, economic growth, and a sense of national confidence.

somewhat smaller standing committee. I hope one of the straws in the wind, that there will be a seven- instead of a nine-member standing committee, proves accurate. I think that will be helpful.

But even within that, assuming Xi Jinping is the leader, things that strengthen his relative leverage within the standing committee I think are, frankly, to the good. Here I think the purge of Bo Xilai is helpful. If Bo had not been removed, I think the odds are that both he and Wang Yang would have made it into the standing committee. They would have been there to balance each other. How do you get a consensus when you've got the key leaders of very different views who happen to hate each other in that small group of nine? So, with the purge of Bo, I gather Wang Yang now is less likely to be in the standing committee. But, anyway, there is a greater potential for shaping a more cohesive group.

I'm not sure about the replacement of Ling Jihua by Li Zhanshu. Some folks have told me that that effectively has strengthened Xi Jinping on the new standing committee. I frankly don't know I'm not sure what to make of it, but thought I would mention it. And, again, the rumors about reducing the standing committee to seven people are a good thing if they prove accurate.

But I think the real keys for what comes out of the 18th Party Congress are the final lineup not only for the standing committee but for the whole array of top posts – Politburo, General Office, Secretariat, Military Commission, and the State Council. And there are just a huge number of unknowns here, especially on the State Council side. Most of those haven't been decided yet at this point. And then also whether Xi can move away from his consensus decision-making system that he inherits so that tough decisions on serious structural reform can be taken.

Here are my three favorite indicators of whether [China is] moving to a more effective kind of system. ... The first one is ... they need to change the operational incentives for local leaders, from province down through township. This means getting them to cease prioritizing those things that fatten their wallets and instead prioritize things that are better for the long-term development of the country. ... Second is to drop the *hukou* system, probably the single biggest determinant of social instability in China. ... And the third is to move away from the one-child policy.

We all have our indicators of whether they're moving to a more effective kind of system. Let me give you my three favorite ones. The first one is hard to measure. The other two are much easier to measure. The first one is – and it's crucial – they need to change the operational incentives for local leaders, for leaders from province down through township. There has been a lot of talk about that over time, almost no effective action. To change the incentives for local leaders is going to mean, in many instances, getting them to cease prioritizing those things that fatten their wallets and instead prioritize things that are better for the long-term development of the country. That takes an enormous amount of political capital to drive through this multilayered system. Hu Jintao never seriously attempted it. If Xi Jinping is unable to make serious progress on this over the next three or four years, China is in very serious trouble.

My other two things are, one, to drop the *hukou* system— the system of residence registration. Inequality of wealth is a major problem in China. This is the single biggest determinant of inequality and distribution of wealth in China. It's probably the single biggest determinant, or certainly one of the two or three biggest determinants, of social instability in China. And if you want to shift to a model of development that prioritizes domestic household consumption as a demand driver for the economy, it is very hard to do it when you take nearly 300 million people and artificially limit the money they can make because you limit the urban opportunities that they have. I mean, it's just absurd.

The biggest obstacle to this, I believe, is municipal government leaders, because if you remove the *hukou* system, then they have to provide the resources for what is now, for the municipal economies, nearly free labor. All the costs are shoved off elsewhere.

And so, again, it will take a lot of political capital and a lot of political courage to do it; but, my god, you think of the harshest parts of the law in Arizona with regard to people who do not have legal status in the United States and the kind of discrimination that that subjects them to and those restrictions are minor compared to the institutionalized discrimination against rural migrants in urban China. That's just not a sustainable situation.

And the third is to move away from the one-child policy. That policy is already a catastrophe for China. I'm not talking about this on ethical grounds. I mean, there's a lot obviously that can be said there. I'm talking about just in terms of the economy and social stability. It is startling that after the results of the 2010 census came out, the fully

disastrous situation that that revealed was well known – the Politburo Standing Committee was briefed on it – but there were still no major changes were made in policy.

My own view, perhaps wrong, is that one of the biggest obstacles to changing policy is there are now 6 million Chinese officials who are engaged full time in implementing the policy. That's an employment problem. Again, it takes some political courage to attack it. But if they don't – frankly, even if they do – this is something that will only play out over a very long time. So I think it is a big issue simply because it's an indicator of whether there is the political courage to take tough, short-term decisions that are no-brainers for the capacity of this system to continue to function well into the long-term future.

If the Party Congress does not produce a leadership that can make and implement very tough choices that require local governments to change their behavior, this does not suggest that China is going to come to a screeching halt. The center is still going to be able to carry out a lot of things simply by fiat.

Note, by the way, that if the Party Congress does not produce a leadership that can make and implement very tough choices that require local governments to change their behavior, this does not suggest that China is going to come to a screeching halt at all. The center is still going to be able to carry out a lot of things simply by fiat.

For example, you can change interest rates, you can increase the quota for foreign institutional investment, you can change bank reserve ratios, you can do a lot with monetary and fiscal policy, but it will fall short of the sectoral rebalancing that is necessary. It will also fail badly on dealing with environmental and wealth distribution issues.

And, therefore, the costs of this system in terms of increasing social instability are going to be greater, and the cost to the system in terms of massive economic efficiency are also going to continue to rise. For all of China's enormous growth, on a national level its level of efficiency of use of resources is very low by international standards. So it's had a tremendous capacity to mobilize resources but not to use them efficiently. That is something that they have to get out of.

I, frankly, cannot foresee the possibility in the coming five years of a significant reduction in elite corruption because the marriage of wealth and power in China is by now so deeply embedded that it's almost impossible to change fundamentally from within, in my judgment. Let me give a few bottom lines and then turn it over to Alice.

The basic bottom line and theme of this set of remarks is China is now in trouble. A lot of the past decade of economic reform occurred because of structural reforms of the previous decade. The reforms in the banking system; in the state-owned enterprise system and, more broadly, enterprise ownership; in management of labor; in

I ... cannot foresee a significant reduction in elite corruption because the marriage of wealth and power in China is by now so deeply embedded that it's almost impossible to change fundamentally from within.

creating a private housing market; in joining the WTO – all of those occurred before Hu Jintao and Wen Jiabao came into office.

But all of them had knock-on effects that we've seen over the past decade that have contributed substantially to the near-tripling of China's GDP in the last decade, an extraordinary level of growth. But there has been no set of reforms in recent years that is providing the basis for rapid growth in the coming decade. So there's a huge reform deficit to make up here.

Now, China's economy can keep growing without major reform, but that growth is going to be increasingly inefficient and socially destabilizing. Without the 18th Party Congress, therefore, I think the prognosis for China's coming five to 10 years will be very sobering. The 18th Party Congress holds out the possibility of doing much better, of putting it on a much better trajectory, but there's a lot that remains uncertain as to how this will actually come out. So the stakes for China, associated broadly with the 18th Party Congress, are very high.

China's economy can keep growing without major reform, but that growth is going to be increasingly inefficient and socially destabilizing. ... The 18th Party Congress holds out the possibility of ... putting China on a much better trajectory, but a lot remains uncertain as to how this will actually come out.

Let me make one final comment in anticipation of the rest of the day, especially because I see Jim Steinberg just arrived a few minutes ago. This new Politburo Standing Committee leadership is going to have an exceptionally full domestic agenda, and it's going to have to build its political capital in order to deploy that capital assiduously to promote structural reform.

A man like Xi Jinping we know – we read about him here all the time. The average Chinese doesn't know him at all. The style in China is not that you build up someone and then make him leader. Rather, someone becomes leader and then you build them up. So he still has to put together his stature, if you will. I think that the size and pressing nature of the domestic agenda is going to make the Xi Jinping leadership want to pursue a very cautious foreign policy and especially to avoid major problems with the United States.

In other words, I think they're going to really want to put the international arena on a calm basis so that they can focus on building the domestic capital they need and then deploying it to address these huge domestic issues. I think this is in the U.S. interest, in part because the reforms that China wants to undertake are very much ones that we want them to pursue. They're in America's interest, too. We can detail that in Q&A if you wish.

But let me say if the U.S. leadership decides that it's time to get tougher on China and take some notable actions to do that, as one of the candidates for president has highlighted he certainly intends to do – I have no idea whether he would do it, but that's his stated platform. If that should occur early next year, I think that Xi Jinping will have to react very strongly, for two reasons.

The size and pressing nature of the domestic agenda is going to make the Xi Jinping leadership want to pursue a very cautious foreign policy agenda ... but if the U.S. leadership decides that it's time to get tougher on China and take some notable actions to do that ... Xi Jinping will have to react very strongly, for two reasons. One is to demonstrate to the U.S. side that that's not a fruitful way to get things done with China. The other is to build his own domestic political capital so he can get done what he needs to do in China, which is his more important task.

One is to demonstrate to the U.S. side that that's not a fruitful way to get things done with China. But the other is to build his own domestic political capital so he can get done what he needs to do in China, which is his more important task. So to be challenged by a U.S. set of initiatives that's clearly designed to show how tough we are so China will come around will make it imperative for Xi Jinping to push back very, very hard, or else his domestic program is likely to be much more difficult to carry out.

I hope this has been helpful. I look forward to Alice's comments. Thank you.

[Applause.]

DR. MURRAY SCOT TANNER: Thank you, Ken.

In the nearly 30 years now that I've had the pleasure of knowing Ken, I've noticed that whenever I start to think that the Chinese system has serious problems, I listen to Ken and I realize what a hopeless optimist I am.

[Laughter.]

DR. MURRAY SCOT TANNER: I'll turn it over to Alice Miller now, who is going to speak for about 15 minutes with some comments on Ken's presentation and thoughts of her own.

Commentator: Dr. Alice Miller, Hoover Institution

Takeaways – Dr. Alice Miller

- The political transition process in China has become increasingly routinized and institutionalized over the past two decades. This institutionalization indicates the increasing desire of the Chinese leadership for stability and predictability.
- There have been several indications that the current transition process has encountered some obstacles, most notably a delay in some of the key meetings that precede the Party Congress.
- The 18th Party Congress provides some useful early insights into the attitudes of the new Chinese leadership toward reforming the policy process.

DR. ALICE MILLER: Good morning. At the outset, let me say just a couple of things.

First, I always agree with Ken. Ken and I were fellow students at the Stanford Center in Taipei in 1969 and '70. And those of you who may have been there they had, upstairs, a *xiuxi shi*, a recreation room in which there was a very prominent ping-pong table.

[Laughter.]

DR. ALICE MILLER: And many of us there played regularly, and Ken always won. And so it became obvious that Ken really had found the Tao of ping-pong –

[Laughter.]

DR. ALICE MILLER: – and that, therefore, more likely – he had found it more generally and therefore it made sense always to follow him rather than disagree.

But I do think he's given us a very insightful picture of the dilemmas of governance that China faces – I agree entirely with what he said – and the need for some sort of transition not just in leadership but in the broader political system itself.

The other thing I wanted to point out at the outset is simply that I started trying to figure out what's going on at Communist Party Congresses in China at the 9th Party Congress in 1969. So this is my tenth Party Congress.

There are two suggestions or implications that I draw from this. One is, this has been a rather odd career.

[Laughter.]

DR. ALICE MILLER: Why would you spend your life doing this? I'm not sure. When you get old it's time for reflection, and I'm reflecting. And the other point is I am old. Over the weekend I turned 68, which means I'm no longer eligible to stand for membership in the Politburo.

[Laughter.]



DR. ALICE MILLER, Hoover
Institution

DR. ALICE MILLER: And the implication of that is simply, I have no idea what's really going on in Beijing because I'm cut out of the loop.

[Laughter.]

DR. ALICE MILLER: So, in that spirit, let me just say that these thoughts will focus on the political process and the politics of the leadership itself that I hope will amplify the remarks that Ken has given us.

First, I think this Party Congress is important, because it's an important benchmark in measuring a trend towards institutionalization of politics in China.

If you go back to the 9th Party Congress and looked at the way that Party Congress was convened and the leadership that it produced, it was obvious that the results of the Party Congress were the outcome of the rather brutal free-for-all politics that pitted at least four factions against each other, with Mao trying to referee among the four. And so, looking at the broader Politburo and the standing committee, one could see a factional balance quite clearly.

These days it's quite different, and I've been trying to make the point for 20-some years now that China has undergone a major transition in political style in the leadership, away from that kind of faction-driven free-for-all competition that we saw in the later Mao years in favor of a much more institutionalized and routinized political process.

This was clear, I think, at the 14th Party Congress in '92 and has grown in clarity, in transparency, and maturity over the following 20 years through the Jiang period and now through the Hu Jintao period. This transformation was deliberately designed by the great intelligent designer Deng Xiaoping in the 1980s to try to produce a political system at the top to serve two basic purposes.

China has undergone a major transition in political style in the leadership, away from the faction-driven free-for-all competition that we saw in the later Mao years in favor of a much more institutionalized and routinized political process.

As China's wealth and power has grown in the reform era, a lot more was at stake in terms of the need for stability. You can't run a country with stakes as high as China has these days with instability, simply for the sake of its economy and prosperity and also for its position in the international system.

One, as China's wealth and power grew and has grown in the reform era, a lot more was at stake in terms of the need for stability. You can't run a country with stakes as high as China has these days with instability, simply for the sake of its economy and prosperity but also for its position in the international system.

And so Deng did try, and I think in some measures succeeded, in producing a more stable, consensus-driven, collective leadership process that was quite deliberately installed and developed under Jiang and then under Hu Jintao.

The other reason that Deng did this was that China, in his eyes, and the rest of the leadership I'm sure agreed, wanted to inhibit the rise of another dictator like Mao, one-man rule that could lead the country astray in the fashion that Mao did after 1957.

And all of this has been manifested in a number of ways: much more predictable political transitions. The transition from Jiang Zemin to Hu Jintao in 2002 through 2005 is maybe the first real example in a major communist system – Vietnam aside, North Korea's dynastic transitions aside – a problem the Soviets never solved. And so, that's one manifestation.

Also, much more predictable and stable policy-making routines have been quite visible: the division of labor in the standing committee and the appointment of people in the Politburo and in other institutions. Each have distinct roles and representational roles rather than simple, factional representation.

And then, finally, in selection of leaders not simply because of their political associations but also because of their experience and expertise. They have a country to run, and it's encapsulated in the party's phrase, the need to be a governing party. So this is a major change in China's leadership style that goes back to the early '80s and reached a kind of maturity in the Hu period.

So the question is, in the subsequent leadership will we see that approach continued? And I agree with Ken strongly that there are reasons to modify it, if not change it in significant ways.

China's political institutionalization is manifested in much more predictable political transitions; more predictable and stable policy-making routines visible in the division of labor in the Politburo Standing Committee, and selection of leaders not simply because of their political associations but also their experience and expertise. They have a country to run.

And so I'm convinced we'll see a smooth succession in terms of Xi Jinping. I don't know where he is either, but I'm not all that concerned. And [he

and] Li Keqiang will emerge in the two top positions, but the rest of the standing committee, whether it's nine people, seven people, eight, six, if it's a consensus leadership you don't need an odd number in the leading group.

All of these things, whatever they decide to do, will signal something because it will change the policy-making routines that have been set up under Hu Jintao. Each of those nine leaders on the current Standing Committee has a specific responsibility, both in representing a policy sector but also in supervising it through the leading small groups. So, if they modify that it will tell us something about what they intend with regard to the policy process. Also, whom they promote into the Standing Committee and into the Politburo will tell us something about the process.

And so it will be an important benchmark in assessing how far the process of institutionalizing this style of politics has gone, or whether we're seeing an effort to modify that, or – and I would think for the worse – they return to much more personalistic, faction-driven politics. I don't think we'll see that.

A second comment I can offer is simply that the hope for a smooth transition suffers a little bit from some indications that things aren't going quite as well as they may have intended. And I'm not referring here to Xi Jinping's absence – if he's in the hospital or whatever the reason; I don't know – but several other things that you almost need a micrometer to find. Anybody know what a micrometer is anymore? They look like computers.

[Laughter.]

DR. ALICE MILLER: That tells you how old I am.

Anyway, one thing is, is that the round of 32 provincial Party Congresses – 32 because Taiwan also has a Party Congress even though Taiwan is temporarily under other management at the moment.

[Laughter.]

DR. ALICE MILLER: It still elects people to the Party Congress.

This was supposed to have been completed in two waves. Now, the first wave was October through December last year; the second wave April through June. It was supposed to be

Whatever they decide to do [at the Party Congress] will signal something, because it will change the policy-making routines that have been set up under Hu Jintao. Each of those nine leaders on the current Politburo Standing Committee has a specific responsibility, both in representing a policy sector and in supervising it through the leading small groups. If they modify that, it will tell us something about what they intend with regard to the policy process, [as will] whom they promote into the Standing Committee and into the Politburo.

over by the end of June but it's carried on into July. And so there has been no explanation for the delay.

A second is the speech that Hu Jintao delivered at the Central Party School. This was delivered on the 23rd of July. This is a tradition that goes back to 1992. Jiang Zemin did it in '97 and '02, having started it in '92. And Hu Jintao did it in 2007 and then this recent 23 July.

Well, this time it was more than a month later than the latest of the previous ones. Now, this could indicate a debate over the contents of the political report that Hu is going to deliver at the Party Congress. Hard to tell what it's about, but it is significantly late by about a month.

Third, there has apparently been a Beidaihe meeting of the leadership. No clear confirmation in media, the Chinese media, that there was, but if you track leadership appearances, there was a period from about the 1st or 2nd of August down through the 13th or 14th of August in which the Politburo Standing Committee just did not show up.

Now, Beidaihe meetings – the big, large scale meetings where the entire government moved down to Beidaihe – were discontinued in 2002. But this year they seem to have done that. But it was not a full-scale Politburo assembly. Clearly the Politburo Standing Committee was there, but much of the rest of the Politburo doesn't seem to have been. Some members continued to appear in Beijing. Wang Lequan, who is on the Politics and Law Committee that Scot is an expert on, did an inspection tour of Heilongjiang. Guo Boxiong, or one of the two military guys, appeared in Beijing in the midst of this, and there were five provincial leaders who were on the Politburo who stayed in their home bailiwicks. Wang Yang, for example, down in Guangzhou, showed up almost every day in Guangzhou. Now, he maybe took day trips up to Beidaihe but I rather doubt it. So this is an odd gathering.

Another thing is simply that there has been a big slowdown in the public schedule of Politburo meetings. From 2002 forward, Xinhua had published almost monthly Politburo meetings outcomes. These averaged, over this nine-year period, about once a month or a little bit less than that. But since the beginning of this year there have been only three, and so one wonders what's going on. Was this a manifestation of some sort of disagreement, suspension of processes as Hu is beginning to step away? Who knows? But it's peculiar.

Then there is the Ling Jihua affair. This, I'm sure you're aware of, is the replacement of the head of the General Office, which is an extremely sensitive position because the General Office manages all the logistical affairs of the leadership: where they live, where their office is, the communications and paper flows into the leadership, their security details when they travel, their travel arrangements, everything. And so the General Secretary needs his guy in that position.

Hu got his guy in there, Ling Jihua, in 2007, and his early removal is a rather curious departure from the pattern that we'd seen of the occupancy of that office for a rather long

time. I don't have a good explanation for this, and I don't know anything about Li Zhanshu either. He had been reelected as the Party Secretary in Guizhou in April, and then in July they move him up to Beijing and in early September make him head of the General Office. So I don't know what that's about, even though I've been watching these things for a long time.

The Bo Xilai investigation, I think there's – I'll just say this – an exaggerated significance of this, perhaps in the Western media anyway. Whenever they decide to hold the Party Congress they will publicize a Politburo meeting that will schedule the Seventh Plenum of the Central Committee that will forward the draft political report for approval by the plenum so that Hu can deliver it at the Party Congress, and in that report they'll also deal with the Bo Xilai affair.

I do expect Bo to be drummed out of the party and then turned over for prosecution under law. There have been a couple of commentaries from Xinhua that have suggested that, but we'll see. So, whether Bo Xilai is a complication in all of this is anybody's guess.

How soon will Xi Jinping put forth an agenda of his own? The classical logic here is that it takes a General Secretary a long time to consolidate his position. But I think that argument is wrong.

A third suggestion I wanted to offer is: how soon will Xi put forward an agenda of his own? The classical logic here is that it takes a General Secretary a long time to consolidate his position so that he can begin to push his own agenda distinct from the outgoing administration's. But I think that argument is wrong.

Hu Jintao didn't do it that way. He was elected General Secretary in November of 2002, and right out of the gate it was clear he was moving in new directions. He went down to Xibaipo, which is this place that the party headquartered itself on the eve of taking over and moving into Beijing in 1949, and began to talk about "people-centered" policies. This is a month after becoming General Secretary.

In 2003 he introduced his "scientific development concept," which was ratified in 2004. And in 2004 we got the first intonations of the "socialist harmonious society," an idea finally ratified in '06. In 2005 we got the "new socialist countryside." All of these were efforts to adjust away from the very high-speed growth pattern in the Jiang years and to try to address some of the side effects and problems with economic development in the previous period.

So I think if Xi does have a new agenda – and I agree with Ken now that it's a propitious moment to push it forward – I think he will have the latitude to do that. In hindsight, going back and looking at the 16th Party Congress report in '02, it was clear that some of those elements that Hu Jintao pushed early in his term as General Secretary were embedded in there. It was just hard to read them with clarity. So I think we may see this emerge quite quickly.

Finally, let me say one thing about the military changes. There will be significant changes in the military brass. At least seven out of 12 members of the current Central Military Commission are going to turn over. This leaves aside the question of Hu Jintao staying on as the chairman of the Central Military Commission. My own belief for a long time has been that he will stay on. He'll follow the precedent of Jiang Zemin and, before him, Deng Xiaoping. But we'll see, and that in itself will be interesting.

But, more fundamentally, we're going to see some new changes in the composition of China's military brass that are really quite unprecedented, and specifically it's in this set of leadership changes in the military that we will probably see the dominance of ground force commanders finally broken in the military brass in favor of people from the more specialized services: the army, the navy, maybe the Second Artillery.

This shift is a consequence, I would argue, of the change in military doctrines in the 1980s up through 1985 or so. From 1959 forward, China had practiced a kind of retrofitted people's war strategy to face the ultimately lethal threats from the Soviet Union and the United States, using space and people as its main assets when nobody else would give them any sort of assistance. And so that favored ground force commanders in leadership positions.

In 1985, Deng argued that, in fact, China no longer faces that sort of existential threat and it needed to focus on a new hierarchy of security priorities on its periphery, and therefore needed a different kind of People's Liberation Army, one that's much more mobile, has higher-tech capabilities, and an officer corps that's trained professionally, and so forth.

All of that mandated money, training and emphasis on the air force and the navy that wasn't true in the people's war era. And so, thanks to the regularized turnover of officers and the shift in defense doctrines, we've now produced a leadership that is bringing to the fore air force and navy people alongside the ground force commanders.

And among the choices for promotion to the vice chairman positions on the CMC and some of the other positions, it's just likely that we're going to see Wu Shengli maybe, or Xu Qiliang, the head of the air force, move into positions that will break this ground force dominance.

This is interesting in longer term simply because it enhances prospects for perhaps enhanced service rivalry within the PLA. There are already intimations of that but I would think that this would exacerbate that. And it will enhance competition for resource allocations for the military. In a time of general economic uncertainty and perhaps downturn, this will enhance competition in ways that could produce a much more contentious politics.

It's in this set of leadership changes in the military that we will probably see the dominance of ground force commanders finally broken in favor of people from the more specialized services. ... This enhances prospects for enhanced service rivalry within the PLA.

And so not just in the military – and especially in light of Ken's insightful comments – I would suggest we face a prospect of much more contentious politics in China simply for the reasons, as Ken suggested, that resources will be increasingly the object of competition as the pie continues to grow but not as fast as it has. And this seems to be a recipe for political competition and conflict. Thank you.

[Applause.]

Q&A for Session 1

ATTENDEE: Susan Lawrence from the Congressional Research Service. Thank you, Alice, for those brilliant comments.

I wonder about Xi Jinping's concept of the "new style big power relations" between the U.S. and China, which he raised at the State Department lunch in February. That seems to be associated particularly with him.

And I'm wondering what you make of the idea that somebody who has not yet even come into office already has a big idea associated with him and think tanks across Beijing at least seem to have been tasked with filling in details of that philosophy. And if you could maybe comment on "new style big power relations" and what it means for the future. Thank you.

DR. ALICE MILLER: I agree with Ken.

[Laughter.]

DR. KENNETH LIEBERTHAL: I think, first of all, that the core notion that they're promoting with this is one that actually goes back to maybe a decade ago when they talked about China's peaceful rise. This is the notion that big powers in the current century need not follow the history of the past century. They can find a lot of areas in which they can cooperate. Competition need not dominate the relationship. Certainly there is no reason to anticipate military conflict between them. Now let's flesh out the argument. And we saw a fair amount of that argument fleshed out when Jiang Zemin raised the "peaceful rise" notion. I see this as the kind of repackaging of that but within a special focus on the U.S.-China relationship in particular. So that's how I see it.

Alice would be the definitive source on this because I haven't looked at it all that carefully in terms of whether this is uniquely a Xi Jinping idea. I thought Hu Jintao had referred to it. And I've heard a lot of Chinese officials raise it, so I'm not sure how distinctly Xi Jinping an idea this is.

Alice, do you have a thought on this?

DR. ALICE MILLER: I agree with your assessment. I'm not sure that it is distinctive to Xi Jinping. I'd trace the roots of it even back a little farther, back to around '97 when China began to talk about a new security concept.

Also, in that same time, Jiang Zemin started referring to China as *da guo*, a big country or powerful country. And it reflects, I think, an ongoing debate and discussion in Beijing about the shifting balance of power on a global scale.

And this has taken on some energy recently simply because the Chinese have, for three or four years, been trying to debate whether the global balance of power has changed in some

decisive way, and I think they're as uncertain as we are. And so I would place that in this broader context.

DR. KENNETH LIEBERTHAL: It may have been, given his visit to the U.S. that this was the right way to roll it out.

DR. ALICE MILLER: Yeah. He would not be putting forward his personal views on a visit to the U.S.

ATTENDEE: Ken and Alice, those were great presentations. Thank you very much.

Back in the old days, when Hu Jintao was head of the Party School, we learned that he was having salons, inviting liberal intellectuals in to talk about liberal topics. And we all said, boy, this new guy is going to be great. He's going to get into power and we're going to have a hundred flowers blooming all over again, and so forth and so on.

Given the way things have evolved – and it's not exactly easy to define closely how Hu has evolved over his 10 years – what can we assume about the ability of any new leader? And even if he does come in and say, we're going to have a harmonious society and we're going to have a scientific concept of development, and so on and so on, you know, right out of the box, what can we really expect of new leaders in terms of opening up the system and bringing fresh air into the highest levels of policy discussion in China?

DR. KENNETH LIEBERTHAL: Bob, I tried to make a major point that the person at the very top has some influence on this obviously, but alone has no serious capability to shift policy in a major way. So you both have to look at who else holds appointments and what their proclivities are, what their areas of responsibility are in this division of responsibility system, but then also the decision-making norm.

I think there was a significant shift that occurred under Hu Jintao, and I don't know to what extent it just reflected the ongoing movement away from having a core leader who could just drive things, from Mao to Deng to Jiang to Hu – you know, attenuation of the role of a single man – and to what extent it reflected what everyone has always said about Hu Jintao, which is he's a consensus builder. He doesn't make his own views known ahead of a discussion. He kind of sums up, doesn't like a lot of personal conflict, and so on and so forth.

The person at the very top ... alone has no serious capability to shift policy in a major way. So you have to look at who else holds appointments and what their proclivities are, what their areas of responsibility are ... and also the decision-making system.

I talked to staff of his when he first came into office. One guy I got to know had worked for him back in the 1980s. And I asked him about Hu's style, and he said, "You know something? You can never tell what he really believes. He's never, ever out front; very hard to pin down his personal views. He's always trying to nudge a consensus."

So, I don't know whether this will continue under Xi Jinping or whether he can change it, but I think insofar as it continues, insofar as it's become a real norm, it's a real problem because it's very hard to make major changes if you require a consensus among people with very different responsibilities who are themselves major figures.

DR. ALICE MILLER: I agree with that. And just to pick up on Ken's analysis of the dilemmas of consensus-driven leadership in his remarks, the kind of collective leadership and consensus-driven processes that Hu has worked to refine, inherited in some measure from Jiang Zemin, face really three problems or three possibilities.

One is it can produce an effective consensus. It seemed to be working in the first term after '02 down through '07. Another possibility is that the collective processes will be undermined in favor of a strong clique, or single leader. That's been blunted. But the third possibility is really stagnation, the failure to really arrive at a consensus, in which case everything is tabled and not much happens.

If you look across Hu's 10 years, the first term saw all the major innovations. They're not credited to Hu, but it's this Hu-Wen leadership that produced them. The second term hasn't seen anything. And people talk about stagnation in the leadership. I think it is a manifestation of this inability to reconcile the interests of the major constituencies that are represented at that level and to work out something that everybody can live with effectively.

The collective leadership and consensus-driven process that Hu has worked to refine ... faces three possibilities. One, it can produce an effective consensus. ... Two, the collective processes can be undermined in favor of a strong clique, or single leader. The third possibility is ... stagnation, the failure to arrive at a consensus, in which case everything is tabled and not much happens.

So, whether Xi can overcome that – they're certainly obviously thinking about that if they're talking about reducing or altering the Politburo Standing Committee's operations in the broader Politburo. Those rules are set at the beginning of a new leader's term. They did that in '87, they did it again in '02, and I expect to see that again this time around.

But, obviously, if I can see and Ken can see and we all can see stagnation, they're aware of the problem and will try to do something, but we may not see it publicly immediately.

ATTENDEE: Thank you both for your insights.

Early on in Dr. Miller's comments you talked about how the final composition of the standing committee will give us a good glimpse into how policy making will go into the future, but I'd like to get a glimpse into what is driving the possibility that they may consolidate some of the standing committee, bring it from nine down to seven members or six members, or whatever it is, which of course will result in a consolidation of portfolios or baskets or whatever you want to call it, or maybe changing things around.

So what's driving just that decision, or does it not really matter and we shouldn't worry about it; it's just semantics?

DR. KENNETH LIEBERTHAL: I'll give you a quick response and then Alice may want to give a different view.

First of all, there's nothing sacred about nine. It went from seven to nine in 2002. That was largely the result of factional balances and Jiang Zemin wanting to have a majority of his followers on the standing committee that succeeded him.

We don't know what's going to happen, but if they go from nine to seven, the other part of that rumor is that the two portfolios that will not have independent standing committee members in charge of them alone are the political and legal affairs, basically domestic repressive apparatus, and propaganda system. Those are also the two portfolios that appear to have been the most conservative political portfolios in recent years.

And so if you either reduce them to Politburo status but not Standing Committee or, I think more likely, have someone on the Standing Committee hold one of those but also hold some other portfolio at the same time so they aren't solely focused on that system, then arguably that could improve the chances of promoting a more reformist agenda.

DR. ALICE MILLER: That's kind of what I meant about, however they resolve this will tell us something interesting about the process they envision and how to get more effective decision making.

I don't know whether ideology and politics and law, the security things, will be the ones that will be combined or reduced or so forth. I find it striking that if China is facing the kind of governance problems that it is, that they will lessen the leadership representation of persuasion and repression, the means of controlling that situation. But, again, you know, we look at this from the outside, and who knows?

But whatever they do, it's going to tell us something immediately in terms of how they think the system ought to operate more effectively. And so, aside from just focusing on the people, the who's who, it will tell us something about the process.

ATTENDEE: Excuse me. I would just like to hear some clarification on one simple question. Does China need peaceful international environment in order to deal with its domestic issues, or does it need international conflict to mobilize domestically to deal with its issues? From what I heard this morning, it sounds like it could go either way or both ways, and to that extent it sounds like it doesn't matter, so I want to hear more clearly on that.

DR. KENNETH LIEBERTHAL: Actually, I do agree it could go either way or both ways, but I think it does matter, because what kind of domestic policies will do best will vary with whether you are mobilizing nationalism to create energy, discipline, and authority, or whether you see a more peaceful international environment and feel freer to loosen up domestically to increase the role of markets and the private sector and that kind of thing.

and perhaps temper a little bit more the nationalist rhetoric and priority to military and repressive organs.

So I think it does make a difference, but a smart leadership will take the hand that it's dealt and try to leverage it.

A smart leadership will take the hand that it's dealt and try to leverage it.

DR. ALICE MILLER: As always I agree with Ken, and I do think it matters. I do think that China wants a stable international environment. It does not see conflict and security challenges as favoring its broader national goals.

If you think that Chinese leaders do think that it would be useful to have conflict and have China facing severe security challenges, think back to the '50s, '60s, and early '70s when China really did face lethal challenges, and the impact that had on China's domestic agenda.

I think I agree a bit with Ken perhaps – maybe I'm over-reading his comments. It struck me that for much of the PRC's history, its domestic agenda has been powerfully influenced by its external security environment and that it extremely constrained the kind of domestic choices that it could pursue. And it's been the removal of those threats since the mid-'80s that has enabled the takeoff that we've seen, but who knows how they'll see it?

DR. MURRAY SCOT TANNER: We could go on with this wonderful topic for the rest of the afternoon. I regret that we have to cut things off here to keep on schedule. I hope you'll join me in thanking Ken and Alice for a couple of terrific presentations.

[Applause.]

Session 2: What's at stake for U.S.-China relations?

Panel introduction: Dr. David Finkelstein, CNA China Studies

DR. DAVID FINKELSTEIN: This panel is going to explore what's at stake for U.S.-China relations, and clearly there is a lot at stake. As we know, in the last couple of years the relationship has been characterized both by cooperation and contention, which, in my view, is going to represent the new normal in this bilateral relationship.

And I think the new normal is also going to embrace the fact that bilateral issues are only one facet of this complex relationship. Regional and global issues are increasingly finding their way onto the top of the diplomatic agenda between the two countries, and this is where cooperation and contention are becoming even more manifest.

And as I mentioned in my opening remarks, the U.S.-China relationship makes both countries ineluctably conjoined on a series of issues that can affect both their domestic and their international interests. And so, for obvious reasons, leaders on both sides of the Pacific are working hard to keep the relationship on an even keel, are working hard to keep it productive, predictable, and positive, but they're not always successful.

And so, to help us appreciate just what is at stake for U.S.-China relations, we are indeed privileged to have with us today James Steinberg, currently Dean of the Maxwell School, Syracuse University, and university professor of social science, international affairs, and law. And as you already know, he brings a remarkable set of experiences to this topic as a government official and from the academy.

And I accused you, Jim, in my opening comments of, like Dean Acheson, being present at the creation of the current administration's policies towards China and Asia. And indeed his impact is still being felt as the initiatives he helped to craft play out today throughout the region.

During the Clinton presidencies he served as Deputy National Security Advisor to the President, Director of Policy Planning Staff at State, and Deputy Assistant Secretary of State at INR. And last year I was privileged to be part of a delegation put together by CAP. Jim was also on this delegation. And I tell you from personal observation that the breadth and depth of knowledge he demonstrated on the issues between Beijing and Washington were amazing to me. It was the first delegation I had ever been to in China – or at least in many, many years – where I learned as much by listening to the Americans on the delegation as I did from our Chinese hosts, and most of that was because of the interjections and commentaries that Jim was making. So we're lucky to have him here with us today. Thank you.

Now, also in the lucky-to-have category, CNA China Studies is lucky to have as one of its analysts Dr. Alison Kaufman. She came to CNA with a rich background in China affairs from

the academy, working for the World Bank's China Program, and at China Radio International in Beijing. She earned her Ph.D. in Political Science from the University of California-Berkeley, with a focus on Chinese political philosophy. I expect to hear some philosophizing today. And at CNA she has written extensively on Chinese strategic culture as well as cross-Strait issues.

Now, her personal research interest is examining the historical roots of China's current-day foreign policies, and I would commend to all of you her article in Pacific Focus entitled, *The Century of Humiliation Then and Now: Chinese Perceptions of the International Order*. And in case you believe this is too arcane to be relevant to today's issues, I would direct your attention to the statement made by Beijing two days ago about the Diaoyu Islands.

So with no further ado, please welcome James Steinberg to the podium. Thanks, James, again for coming.

[Applause.]

Speaker: Dean James B. Steinberg, Maxwell School of Syracuse University

Takeaways – Dean James Steinberg

- We are entering into one of the most consequential periods in Sino-American relations in several decades. Leadership transitions in both China and the United States will have a profound impact on this relationship.
- There is little consensus in either country about how to characterize the Sino-U.S. relationship, or about where it should go in the future.
- China's collective decision-making and institutionalized leadership transitions add an element of stability to the Sino-U.S. relationship.
- Three factors make stability in the bilateral relationship more difficult: Chinese populist nationalism, the actions of other countries in the Asia-Pacific region, and a freer Chinese press.

JAMES B. STEINBERG: Well, thank you, David, for that overly generous introduction. It's great to be here. There are many, many distinguished scholars here in the room whom I have had the privilege of working with over the years, and I'll look forward to your questions and comments as well. I don't want to take up all of the time, so we can have a discussion.

I also am privileged to follow after Ken Lieberthal, who has been a good friend and colleague for a long time. And Ken's observations, which I fully share, really helped set the stage for what I want to say, and especially the points he made at the end of this talk, which are quite relevant to what I want to talk about this morning.

I think it's fair to say that we are now entering into one of the most consequential periods in Sino-American relations certainly since Tiananmen and perhaps since the normalization of relations between the United States and China in the 1970s.

There is a broad consensus in the United States, in China, and practically every place else in the world that the bilateral relationship between the United States and China is the most significant state-to-state relationship in the world today. That may be the only thing that we all agree on, and it has certainly become clear that this is so central to both countries' futures.

We are now entering into one of the most consequential periods in Sino-American relations certainly since Tiananmen and perhaps since the normalization of relations between the United States and China in the 1970s.

But there's also, as you've begun to hear in the earlier conversation, little consensus about exactly what that relationship is, both what it is today and where it's likely to go. And it's

reflected in the typical debate in both countries. As all the sinologists know here, this is a deep preoccupation of the Chinese as to what to call the relationship. Nouns and adjectives fly. It's a partner, it's a friend, it's a competitor, it's a rival, it's an adversary, and the like, and each of these labels tends to bring with it an associated set of policy prescriptions: cooperate, engage, confront, contain, et cetera, et cetera.

And that debate about labels and characterizations, which is so meaningful and occupies so much time, even in the negotiations between the United States and China as we draft joint statements and communiqués and common press points, really does reflect this very important period of uncertainty in the nature of the relationship as it's going to go forward, which has, I think, huge consequences for both countries, for the region, and indeed for the world.

This uncertainty about how to characterize both where we are and where we're going is reflected in public opinion. I recommend to you the recently issued study by the Chicago Council on Foreign Relations. It's always an enormously valuable tool, but in recent years, commendably, the council has focused on U.S.-China issues and especially, in this survey, on East Asia issues, also on Japan and South Korea – very interesting findings there. Perhaps the most interesting of all to me is the fact that Americans are exactly evenly divided between those who characterize the relationship between the United States and China as rivals or as partners: 49-48. It's really quite extraordinary and I think it reflects the uncertainty of the position we're in.

Although there's deep division [in the U.S.] about how to characterize the relationship, there are strong majorities who favor a strategy of cooperation towards China rather than confrontation, even among those who see the United States and China as rivals.



JAMES B. STEINBERG, Maxwell School of Syracuse University

I would add – and I think this quite important and should be significant to policy makers going forward – that although there's deep division about how to characterize the relationship, there are strong majorities who favor a strategy of cooperation towards China rather than confrontation, even among those who still see the United States and China as rivals.

In their recent discussions – getting back to when I was still in the State Department – both Secretary Clinton and Foreign Minister Yang have characterized the relationship –simply as an unprecedented

relationship. And in some ways I think that is the most useful construct rather than trying to fit it into some of these boxes. I think the discussion we had about Xi Jinping's comments

when he was here in Washington, and some of these other observations, do reflect the fact that this is something special and different that is going on.

For those IR theorists out here – and I spend more time with them these days than I did back when I was in Washington – what makes this so important is exactly the conversation that Ken and Alice had towards the end there, that in IR theory this is a period of power transition where a rising power is reaching near parity, if not parity, with the established power. And what the IR theory and some of the research suggests is these are indeed periods of great instability. And as I'll go on to argue, it doesn't mean that the outcome is foreordained or that conflict is necessary, but for sure it's a period of uncertainty.

And the question both of how the established power will deal with the rising power and how the rising power itself will see itself, as either a largely status quo power in which the rising power is trying to become part of the system, or as a revisionist power, is really critical to going forward. And it is the question that Ken identified that goes back to Jiang Zemin and others, as to whether a new pattern can be established here. And obviously that leads us to the conversation we're having today about the political transition in China and what the consequences will be for that relationship.

This period is especially consequential because we have transitions potentially going on in the United States, and certainly going on in China, and because it comes in the context of the changes that the Obama Administration set in motion from the beginning of the administration. And I'm not going to try to decide what the verb is here to characterize what it is.

But clearly this focusing of attention and trying to articulate a long-term strategy for the United States in the region has consequences across the full range of efforts. It has consequences on the security side in terms of overall strategy, in terms of our basing and cooperative relationships in the region, in terms of our operations and activities on the ground and in the region, in terms of the equipment that our military buys, but also across the full range of diplomatic and even economic issues.

As many of you know, even issues like trade – and we're fortunate to have Carla here – have become not only issues about trade but about broader geopolitics. And the discussions around TPP [Trans-Pacific Partnership] go well beyond the consequences for expanding trade in the region, but have been seen in a very geopolitical sense.

Trying to articulate a long-term strategy for the United States in the region has consequences across the full range of efforts: on the security side in terms of overall strategy, in terms of our basing and cooperative relationships in the region, our operations and activities on the ground ... but also across the full range of diplomatic and even economic issues.

So there are important decisions that have been set in motion on the U.S. side, and they will have consequences for the relationship going forward. And of course how we act then stimulates response on the Chinese side. It's a two-person game and the Chinese are watching and trying to understand what the U.S. strategy is going forward. And, to some

extent, China's own response reflects both its own assessments of what China needs for the future but also what the United States is expecting.

While we don't have as good an equivalent as the Chicago Council survey for the Chinese attitudes towards the United States, there is some data on this. A recent Pew survey, for example, suggests that the balance is slightly less good on the Chinese side, but not by a lot: 48-to-43 unfavorable views of the United States versus favorable. It is close enough within the sampling to suggest that Chinese seem to be divided as well in thinking about how to characterize the relationship, and that's gone up and down. It's very interesting and may be only a statistical anomaly, but in 2010 in the Pew survey, favorable attitudes towards the United States were much higher. They've come down since then back to what has been the historic average over the last two decades. You've heard some discussion already this morning about why that is and what are the things that may be going into influencing Chinese attitudes, but we certainly see it not just in these polling data but in the very vivid conversations that take place on Weibo and the newly unleashed Chinese media, like *Global Times*, which are clearly taking a much more confrontational approach towards U.S.-China relations.

So that sets the stage for the question about just how important is this 18th Party Congress for Sino-American relations and indeed, in general, how important is the composition of the Chinese leadership for the long-term issue?

Going back to many of my IR colleagues, not all of whom I agree with, they would argue that largely it's structural forces that are going to determine this, and the composition of the PBSC or the broader leadership is largely irrelevant to the future trajectory of the relations.

I don't fully share that and I think that there are reasons to think that these choices do make some difference. They're not decisive. It's not solely the matter of the will or outlook of the individuals in the leadership role as a general proposition, but especially in China, for some of the reasons that you've heard from Ken and Alice and others. We clearly, I think,

have seen – and Ken articulated this very well – that as China moves towards the collective leadership style, that individual views appear less important and less likely to induce big swings in Chinese policy. There is a deeply conservative element to this approach to both the selection of leaders and of the way in which the leaders govern.

My own experience suggests that the collective leadership in China has played a very important role in stabilizing U.S.-China relations over the last decade ... At every period in which elements of instability or difficulty have risen in the relationship, the instinct of the collective leadership has been to try to right the boat ... and get back to a stable equilibrium.

But I also think that although leaders are very much the product of their own histories and of the domestic challenges that China faces, my own experience suggests that the collective leadership has played a very important role in stabilizing U.S.-China relations over the last decade and especially over the past three years, and that what we have seen is that

at every period in which elements of instability or difficulty have risen in the relationship, the instinct of the collective leadership has been to try to right the boat, as it were, and get back to a stable equilibrium.

Just think back about the rather rocky period after the administration announced the Taiwan arms sales in 2010; the Dalai Lama's visit; the disagreements over how to handle the sinking of the South Korean frigate, the Cheonan. In each of these cases where the tensions and the rhetoric began to rise between the two, we saw very concerted efforts on both sides, but distinctively by the Chinese leadership, to find a way not to let these incidents get overblown, most vividly illustrated in the decision by President Hu to make two visits within 12 months to the United States, first to the Nuclear Security Summit in Washington and then his state visit the following January.

These are obviously not decisions that Hu himself makes, as we heard. These are collective decisions, but they came right in the wake of periods in which there had been difficulty in the relationship and I think represented a strong signal by the collective leadership to try to keep the overall tenor of U.S.-China relations on track.

And so that conservative instinct, and the projection that Ken and Alice suggested, that we're likely to see continuation of the collective leadership style, is a reason to believe, I think, that there is going to be some stability and some continuity, or an instinct for stability and continuity following the new leadership lineup.

And yet it's also true that while we have very little insight to what the potential new members of the Standing Committee think about U.S.-China relations, in the broader intellectual community and the strategic community in China, there is much more debate. There are more people who are willing to raise questions about the strategy of peaceful rise, of accommodation with the United States, of trying to manage differences or even put aside differences, and more advocacy in the punditry community, in the think tank community, in the broader press in China. And the continued debate about "hide and bide" and the implications for China is something that is certainly much more vibrant in the outside world.

In the broader Chinese intellectual community and the strategic community, there are more people who are willing to raise questions about the strategy of peaceful rise, of accommodation with the United States, of trying to manage differences or even put aside differences.

As I suggested, at least the current leadership seems to have staked its flag very clearly in terms of continuity, a very significant decision to publish Dai Bingguo's article on U.S.-China relations and to make clear that the position of the leadership was for the foreseeable future. And that's a fairly decent time horizon, certainly in Washington terms. It is for the next decade or more to continue that basic path, which is a pretty strong indication that, for the current leadership, that that is something that they do prioritize. And for the reasons that Ken suggested, I think that's likely to continue.

Again, the process favors continuity. The leadership background clearly favors an attention to domestic issues. If you look at the composition of the likely members of the standing committee, these are not foreign policy specialists, right? These are people who made their careers, for whom all their instincts, all their focus has been on dealing with the internal problems of economic growth, of social justice, of dealing with social safety nets, of environment and the like as they've been risen up through the ranks of provincial party secretaries and the like. They're not people who come out of a national security apparatus. Few of them have had substantial operations there. So by training, instinct, and experience they're going to focus on domestic issues. And as the answer to that last question suggested, I do believe that will lead the leadership to want to have a reasonably stable environment, and especially to have a good relationship with the United States, because it remains not only the most important strategic relationship, but also the economic relationship is so central to China's future.

The leadership background clearly favors an attention to domestic issues. ... These are people who made their careers in dealing with the internal problems of economic growth, of social justice, of dealing with social safety nets, environment and the like ... They're not people who come out of a national security apparatus. ... By training, instinct, and experience they're going to focus on domestic issues, ... and I believe that will lead the leadership to want to have a reasonably stable environment and a good relationship with the United States.

So the background and orientation of the leadership I think will also tend to favor continuity and stability following the Party Congress. And the very fact that these social domestic challenges are growing in China and becoming more and more difficult to manage again would seem to reinforce this conservative instinct about how to manage Sino-American relations.

Indeed, having said that they're not foreign policy specialists, I do think it's notable that the current likely lineup of leaders are individuals who, at least on the margin, have actually had more exposure to the United States than their predecessors. Xi Jinping visited the United States not just as vice president but before. And as you have heard from his public remarks, and from my private conversations with him, that made an impression on him. He has at least some sense of the United States beyond dealing with government officials. Li Keqiang has also dealt extensively with Americans in his economic activities. Depending on the future of Wang Qishan, there might be someone else in the Standing Committee with extraordinary engagement with American counterparts.

So this is not going to be a completely new set of personal relationships that are developed, and I think these individuals, in their current positions, have suggested that they see a great deal of importance in stable and constructive relationships with the United States.

We're all reading tea leaves, but there's reason to believe to some extent that Xi's own background and his engagement with the military may also give him slightly greater ability to influence the way that the PLA thinks about some of these issues. Again, it's a bit of a

speculation in there. I know there's many here who probably know more about this than I do, but my own sense is that he has cultivated relationships in ways foreshadowing his role, if not immediately then eventually, as chairman of the CMC that would have an impact on that.

So these are all factors, in my mind, that can lead us to expect reasonable continuity and a fair degree of commitment to try to manage Sino-American relations following this Party Congress. But, having said that, there are a number of forces that lean against that, and we heard some of that discussion earlier this morning.

Some of the domestic issues that the new leadership will have to deal with call for standing up to the United States, especially on the economic front There may be more economic nationalism on the Chinese side going forward as the problems of sustaining growth become greater.

Some of the domestic issues that the new leadership will have to deal with do call for standing up to the United States, especially on the economic front where there are going to be priorities in terms of sustaining jobs and economic opportunities in China that may lead to a set of economic policies that are more protectionist, more mercantilist, that will cause confrontation. Given the priority that the leadership is likely to put on these domestic issues, it means that the likelihood that they are going to accommodate the United States on these issues may be less. There may be more economic nationalism on the Chinese side going forward as the problems of sustaining growth become greater. I'll be interested in Carla's perspective on that.

And also, as we heard some discussion of this morning, these fundamental problems of the legitimacy of the Communist Party and its leadership also could cause problems. The comment that David mentioned this morning, I think that was a nonauthoritative comment about the "century of humiliation." But in any event, it reflects the fact that there is a strong undercurrent of nationalism in the Chinese public that suggests that the leaders are going to be very sensitive to being seen as perpetuating this period of excessive accommodation to the United States, of the need to stand up and be more willing to assert nationalist positions, especially in the face of the United States. More than one very senior Chinese official regularly complains to us on the American side about the heavy pressure they get from the netizens who are making their lives so difficult in terms of managing Sino-American relations.

But, again, with these issues of legitimacy, the question of what's the claim of the Communist Party to continue to govern, and especially as the economic challenges get greater and the ability to point solely to growth as the legitimator [is challenged], nationalism is likely to be an important force, either as an affirmative strategy for the leadership or as a defensive strategy so as not to get out-flanked. In this sense I do think that the Bo Xilai issue is more than just an individual issue. I do think that some of the themes that Bo was relying on for generating his own popularity are troubling, in the sense that it suggests that a leader who is trying to appeal to the public as his own political

strategy saw appealing to some of that kind of nationalism to be an effective strategy for mobilization. So I think that's another reason to be concerned.

And a third reason to be concerned, despite the positive forces, is the presence of third-party problems, which immensely complicates the management of Sino-American relations. We see this obviously right now in the territorial disputes in the South China Sea, around the Senkakus, and in general the sense that we see, as a part of an American strategy, a very important commitment both to our broad national interests in freedom of navigation, in rejection of the use of force to solve international problems, but also because of the relationships and commitments that we have to allies, and a feeling on the Chinese side that we are, at best, naïvely being manipulated by our friends and, at worst, in league with them to try to harm Chinese interests.

And we see this especially when the United States engages with partners, whether it's on issues of basing, issues of territory and the like, that this creates a deep sensitivity that complicates the management going forward. And while the Chinese leadership may be especially sensitive about trying to stabilize Sino-American relations, there are some suggestions that it's less sensitive about stabilizing its relations with its neighbors and at least vis-à-vis other countries, particularly Vietnam and the Philippines right now, is more willing to take a more assertive attitude.

Third-party problems immensely complicate the management of Sino-American relations. ... We see this especially when the United States engages with partners, ... that this creates a deep sensitivity [in China] that complicates management of the relationship going forward.

And a fourth reason is the more vibrant and less-directed press, including Internet but also the other press, creates an environment which is not friendly to the quiet management of differences between the United States and China. So as each side tries to deal with the fact that there are both important reasons to try to sustain stability in the relationship, there are also lots of forces working against it.

The ability to take advantage of constructive structural forces and to deal with the underlying tensions, especially the ones that come from China's growing capability ... means that leadership becomes especially important.

And I do think this is the big challenge. In my own judgment, the ability to successfully take advantage of the constructive structural forces and to deal with the underlying tensions, especially the ones that come from China's growing capability – its inherent and inevitable increased military capacity, its ability to project its own interests more effectively – means that leadership becomes especially important. It's precisely because of the structural problems that leadership becomes important.

I'm not here to comment on the challenges of leadership on the U.S. side in managing Sino-American relations, but I do think this question about whether the collective leadership, or whatever the new form of leadership is after the 18th Party Congress, is strong enough not

only to believe, privately and in Zhongnanhai, that this is a good thing, but to actually get out there and manage all these forces in Chinese society that might try to undermine it is quite important.

And so in that sense I share Ken's hope that we do see strong leadership. There is obviously a risk that comes with strong leadership in that it could be in the wrong direction, but I think the greater danger is a more passive Chinese leadership that lets these structural forces move forward on their own, forces within the military, within Chinese society, and the like.

And as a part of that – and I'll conclude with this – going to the question what happens, both following our elections and following the Party Congress, the question of the personal engagement of the leaders becomes so important. Again, you can over-rate leadership. I know many of my IR friends do. But the fact is that one of the things that has had an enormous impact, I believe, in stabilizing Sino-American relations is the much greater degree of interaction between leaders, starting with the President. I've lost track but I think we're at 12 or 13 meetings –

DR. DAVID FINKELSTEIN: Twelve.

JAMES B. STEINBERG: – 12 between President Obama and President Hu, beginning with a phone call in February 2009, with a London meeting in April 2009. I can't pretend that these are the most warm and candid meetings, but they reflect the commitment on both sides and at the leadership to actually talk about some of the real issues. And some of the more private sessions, like the dinner that was held in the White House during President Hu's state visit, especially reflect, I think, an opportunity for the two leaders to understand each other.

One of the things that has had an enormous impact in stabilizing Sino-American relations is the much greater degree of interaction between leaders, starting with the President ... and permeating down. The inauguration of the Strategic Security Dialogue ... begins to put into play the opportunity to build relationships among security officials.

And then it permeates down. I certainly can't count the number of times that Secretary Clinton has met with the Foreign Minister and the State Counselor, and the tremendous interaction that's been stimulated by the Strategic and Economic Dialogue across the board. For myself personally, the inauguration of the Strategic Security Dialogue, which I attach particular importance to because I think it is an area where the greatest dangers exist, begins to put into play the opportunity to build relationships among security officials in ways that don't really exist even in the still rather perfunctory mil-to-mil relationships that we have.

And I think it is important because, as Ken also observed in his remarks, although we are very focused on the Standing Committee, there are a lot of other important people who are going to have new jobs in the coming months, beginning with the State Council. And we've

seen, over the last two decades, not only the growing importance of the State Council in managing Sino-American relations, but in many other parts of the leading apparatus as well, below the Standing Committee.

So there's a lot to be looked at. I especially value Alice's observations about the PLA. We need to understand a lot better about who the new generation of leaders is going to be there and begin to build the relationships there as well.

So, bottom line, while I don't expect huge changes from the 18th Party Congress, I do believe that what this new leadership does and how it approaches the question of Sino-American relations is going to be enormously consequential, and therefore the stakes indeed are very large for U.S.-China relations.

DR. DAVID FINKELSTEIN: Thank you.

[Applause.]

Commentator: Dr. Alison Kaufman, CNA China Studies

Takeaways – Dr. Alison Kaufman

- In looking at bilateral relations, we need to focus more on “the realm of the probable” rather than the “universe of the possible.”
- The upper and lower limits of the bilateral relationship rest on factors beyond individual policy-makers’ control, such as history and economic interdependence.
- Policy makers should ask themselves: What is possible in the bilateral relationship; where within the realm of the possible do they want it to be; what factors can serve to push the relationship in a more positive or negative direction; and which of these factors are most vulnerable during a period of leadership transition?

DR. ALISON KAUFMAN: Well, thank you very much for the opportunity to follow both Dean Steinberg and this morning's panelists. I learned a great deal.

As Dave mentioned, I spent the last year at Harvard looking at some more historical issues in Chinese foreign policy, and particularly I was looking at the 1920s, which was a very tumultuous period in which there were something like four competing governments, 16 heads of state and perhaps 46 prime ministers in just a few years. So I think whatever we can say about the 18th Party Congress, unless things go extraordinarily badly, we can probably expect a somewhat smoother transition than the period of the 1920s. So that's good news anyway.

One other thing about that period that was especially interesting to me was the extent to which the United States was very involved in China's international position, even though at the time it was very unclear what that value was for the United States. And of course we're no longer in that position at all, right? The nature of the relationship is now recognized to be extraordinarily valuable to both countries.

The terminology that is most often used is some version of “intertwined, interdependent, inextricably linked.” There is a recent edited volume out that calls the relationship “tangled,” which I think is a very good way of capturing the extreme complexities and messiness of the dynamic. It's very difficult to pull apart one strand or one domain of the economic, military, diplomatic, person-to-person relationship without touching on all the others as well. The terminology notwithstanding, it's very well acknowledged that the well-being of the two countries is very closely tied together. Policy actions in one

Policy actions in one country in almost any domain – economic, diplomatic, military – have the potential to affect that and many other domains in the other country.

country, whether planned or not, in almost any domain – economic, diplomatic, military – have the potential to affect that and many other domains in the other country.



DR. ALISON KAUFMAN, CNA
China Studies

We've heard a great deal of what I would call expert testimony today, and we're going to hear a great deal more, so I'm not going to try to add to that for people who have a great deal more policy experience than I do, but what I would like to do is pull back a little bit and try to provide a more general framework for thinking about the question, what's at stake in the U.S.-China relationship, and what possibility is there of new leaders actually having an impact on it?

In the broadest sense, the short answer to the question, what's at stake, because of this intertwined nature, is "everything." At the same time, I think that providing only that very broad characterization of the relationship, the most important bilateral relationship in the world, et cetera, has the possibility of leading to extreme thinking.

As Dean Steinberg pointed out, labels are very important in foreign policy because they do actually help to set policy and they help to gain constituencies or persuade groups of people what the most appropriate foreign policy would be. By characterizing the relationship only as "extraordinarily important," it can become easy to think about what would be jeopardized if the relationship were absolutely the worst it could possibly be, or to dream about what might be possible if the relationship were absolutely the best it could possibly be.

So we see some statements, especially in the popular press, to the effect of – if the bilateral relationship between the U.S. and China were to go absolutely as far south as it was possible to go, it would be almost impossible for either country to do all kinds of things that they would really like to do. The two countries could, in theory, refuse to trade with one another, and thereby fundamentally alter the global economic and financial system. They could block one another on every issue that came before the UN Security Council and other consensus-based institutions. They could refuse to cooperate on any global security issues, and so on.

On the other hand, if the bilateral relationship were perfect, if it were unambiguously completely positive in every domain, in theory, the countries could cooperate and coordinate on just about anything. We could solve global warming. We could minimize terrorism. We could create Schengen-style open borders, labor markets, a common currency. I haven't actually heard anyone propose those, but that's what can happen when countries have extraordinarily good relations with one another.

Now, in a year of leadership transition especially, I think extreme scenarios, and maybe especially the negative ones, can get a lot of attention and they can become the object of a lot of speeches and advocacy – not necessarily from officials, who I think, as people have pointed out today, have a great interest in maintaining a degree of evenness, but among people who like to talk. And of course in the U.S. we have many people that like to talk, and in China we have many people that like to talk, and increasingly they are talking in social media and elsewhere.

The big problem with these scenarios is that they are, I would argue, quite unlikely. The universe of possible interaction between the two countries and, therefore, possible consequences is enormous, but it seems much more likely that the relationship is never going to make it to the outer edges of that universe. There have been times in U.S.-China relations that it has been pretty far to either extreme, but that doesn't seem to be where we are right now, and it doesn't seem to be where we have been since the beginning of the reform era.

It seems far more likely that the relationship at this point is going to stay somewhere closer to the middle, and in that sense I think it makes more sense to think about the universe of the probable. What is the universe of interactions that are most probable given current trajectories, given the present and future limiting factors that we've already heard a lot about, given past history, and barring truly catastrophic change to the international system as it is today, or a really fundamental shift in the basic domestic ideologies and interests of either countries?

What I want to do with the rest of my short time today is to raise four framework questions, related to what I call the "universe of the probable," and to highlight some policy implications from those, going forward.

The first question I would raise is: what are the most likely upper and lower limits, realistically speaking, of cooperation in the U.S.-China relationship? What is the floor below which decision makers in both countries probably would never be willing to let the relationship deteriorate, given the degree of interdependence and these long-standing interests and connections, that people today have been highlighting and that exist on both sides?

And on the other hand, what is the ceiling? What is the absolute upper limit of cooperation that decision makers in the two countries would realistically desire or that populations in the two countries would realistically accept, especially given those various limiting concerns that people have been bringing out: resources, domestic priorities, relations and

In a year of leadership transition, extreme scenarios can get a lot of attention. The problem with these scenarios is that most of them are quite unlikely. The universe of possible interaction between the two countries, and the possible consequences, is enormous, but ... it is more likely that the relationship is going to stay somewhere closer to the middle. It makes more sense to think about the universe of the probable.

What are the most likely upper and lower limits, realistically speaking, of cooperation in the U.S.-China relationship? What is the floor below which decision makers in both countries probably would never be willing to let the relationship deteriorate, and what is the ceiling, or upper limit of cooperation that decision makers in the two countries would realistically desire so that populations in the two countries would realistically accept?

obligations with other countries, national identity, and so on? Ken especially pointed to some of the major upward-limiting factors of China's domestic capacity and concerns.

It's within that space, an upper ceiling and a lower floor, that this universe of the probable, or what we could call a sort of realm of cooperation, probably exists for this bilateral relationship. And so when we ask what's at stake in this relationship, or actually with any bilateral relationship, I think what most of us are really saying is, where in this realm of the probable are we going to end up? For policy makers in a new administration in both countries, that is really one of the key policy questions: Where are we now, how did we get here, and where do we want to be, within, the realm of the probable rather than anything that is theoretically possible?

And of course the second question following on from that is, where should we aim to be within this realm of cooperation? It's easy to say, we want the relationship to be as good as possible, but there are many factors that would suggest that not everyone in every country does want it to be absolutely as close, as tightly intertwined as is possible to be. How far apart, crucially, are the preferred positions of each country in different domains: military domains, economic domains, diplomatic, and so on? They may not be the same for each domain. They may desire a greater degree of cooperation in some areas, a greater degree of competition if not necessarily contention in other domains.

Are there tradeoffs that one or both sides may choose to make where increasing cooperation of one domain may actually require decreasing it in another, and are we aware of what those tradeoffs are?

And can we create a realistic assessment of where the preferences of the two countries will probably remain divergent for some time to come, so that trying to force them closer together might create an additional source of tension? Policy makers might choose to do that for various reasons, but they at least need to be aware that the divergence of preferences may not always be an accident. It may be a result of very deep-rooted factors on both sides.

And what's the best strategy to minimize those frictions that do exist and that will probably persist, and to reduce the opportunity costs associated with having a suboptimal U.S.-China relationship? These are questions not just to ask about the other country but about ourselves as well.

The third question is: If we can figure out where we are now, and where we want to go, what are the factors that are most strongly going to push the relationship closer or further away from our preferred position within that realm of cooperation?

Relationships don't just move. Things happen to move them, and there are certain factors that are fairly consistent over time. If the U.S. and China each have a preferred position for that relationship within the realm of the probable, what could happen to move them closer to or further from that point? Here I think looking to the past is an especially useful guide.

One factor that has created tensions in the relationship in recent years – and I think everyone in this room is quite familiar with them and they've been spoken to already this morning – is each country's uncertainty of the other's intentions. This is an issue that is raised almost continuously by the leadership of both sides. It's been particularly highlighted recently with regard to military planning, but it would apply to many other policy areas as well. Both countries agree that this makes it more difficult to establish strategic trust. So there seems to be a consensus that such trust is desired, but then the question of whose intentions would need to be known in order to agree that this is how we're going to get there and so on, remains a point of contention. This degree of uncertainty tends, I think, to push the relationship away from the preferred position of both governments.

What are the factors that are most strongly going to push the U.S.-China relationship closer or further away from our preferred level of cooperation? One is uncertainty of the other's intentions. A second is differing perceptions of each other's national interests. A third is third-party actions and obligations. And a fourth is unrealistic expectations for what the other country's leadership may be willing or able to do.

Differing perceptions of, or at least expressions of, the other country's national interest and one's own country's national interest is another factor that can sometimes push the relationship further away from a preferred position. There are often differences of opinion about which activities of one country may infringe on the interests of the other. And this goes, again, across realms: diplomatic, economic, military.

A great deal of contention that we've seen – certainly in the WTO and in areas related to security issues – point to this concern, that each country believes that it has, or states that there are, certain national interests, and the other one says, well, those bump up against ours, and so on. And this definition of national interests is, I think, a moving target. This has changed a lot over the years but it seems to have been an issue lately, pushing both countries away from a preferred position of stability and of cooperation where possible.

The third issue, which Dean Steinberg already pointed to, is third-party actions and obligations. Obviously the U.S. and China are not the only actors in the region, we never have been, or in the world for that matter. And we've been really reminded not just in recent weeks but I think in recent years of the basic fact that other countries don't just do whatever we would like them to do in any given time. There are many, many independent

autonomous actors in the region and in the world, and they have their own interests and concerns. They have their own preferred areas of cooperation, their own preferred upper and lower limits to these relationships. And that has a huge impact on the way that the United States and China behave in the region, and in the way that they each perceive the other country behaving in the region. That's a major factor and largely, in many ways, beyond our control in moving the U.S.-China relationship forward. So we have to think about how to manage our responses to these often unpredicted actions by third parties.

And the fourth thing that often can push the relationship further away from its preferred position are unrealistic expectations for what the other country's leadership may be willing or able to do. And this is especially vulnerable and important in this time of leadership change. The first panel especially spoke to this. There will be new leaders on both sides. We don't know who it will be in the United States. We think we know who it will be in China, but it's been a surprising fall – or summer, I guess.

On both sides, they will be trying to put their stamp on policy. And often this is done with the help of rhetorical flourishes, reaching out to various domestic constituencies, gaining friends. And it can be very easy in times like that to really misunderstand or mischaracterize or ignore these long-standing probable outer limits of the relationship. It can be easy to suddenly move back into the universe of the possible rather than the realm of the probable, and to make promises to domestic constituencies or to other friends or partners, to make promises that speak to extremes, because extremes are rhetorically much more interesting than a middle ground.

It can be easy to make promises that speak to extremes, because extremes are rhetorically more interesting than a middle ground.

When policy makers are thinking about how to keep this bilateral relationship from moving in a more positive direction, they might want to ask themselves how to minimize these factors: factors like unrealistic expectations; factors like a poor, unthoughtful response to the actions of third parties; factors like uncertainty, or like wildly divergent perceptions of national interests, and so on.

On the other hand, there have been a great number of factors, especially in recent years, that have contributed to much greater cooperation. And I think there has been much greater cooperation on many issues of global and regional import than anyone could have expected a while ago, both because of the increase in capacity of many of China's bureaucracies to do things in the wider world, and an ongoing great emphasis in both governments on making this relationship work. One way, of course, to do that is to go out and do things together. We've seen quite a lot of that in recent years. We might call this a move closer to the ceiling, closer to the upward limit of the relationship.

Some examples of these factors – and there are very many, but just a few. One is that there has been a growing consensus on the utility of multilateral approaches to deal with many regional and global problems, and I think this is very important. This has been particularly true in nontraditional security, where we have seen a great deal of cooperation, a growing

There has been a growing consensus on the utility of multilateral approaches to deal with many regional and global problems, especially in nontraditional security, and in global finance and economics. There has been some shared belief that global institutions can and should exist, and can be used as fora in which to talk about certain issues, and there is interest in both sides on continuing to keep these issues open for discussion.

amount in recent years, and also in global finance and economics, WTO disputes notwithstanding.

And I think Ambassador Hills will talk more on this issue, although she may disagree with me, that there has been at least a belief that global institutions can exist; that they can be used as fora in which to talk about certain issues, that not everything has to take place behind closed doors; and that there is a degree of interest in both sides on continuing to keep these things open for discussion. And this has allowed for cooperation in all kinds of areas. There's counterpiracy, counternarcotics, dealing with trade disputes at some times in a more adult fashion, and so on.

Another very important factor pushing the relationship in a more positive direction has been a general preference for pragmatism over ideology, certainly in the last couple of decades, in both countries on many issues of substance. Dean Steinberg pointed to this when he noted the great efforts of the Chinese leadership to stabilize relations even in periods of friction, where the friction sometimes is really on matters of principle. It's hard to reconcile principle, but the countries have somehow managed to work it out, even at times of very great tension in recent years, when I was looking at the news reports and thinking, I don't know how they're going to work this out. Yet somehow we've gotten through them. We still have a diplomatic relationship. We still have cooperation, and so on. So there obviously is a commitment to that. And I would in general call that a preference for pragmatism, for the understanding that it is important to keep things moving forward even when the broader principles may diverge.

A final factor moving the relationship more towards its ceiling is a shared belief that talking is better than not talking. That sounds obvious, but there have been points in China's interaction with the world historically that that was definitely not the case. And I think it's extremely important. It's allowed for the growth in high-level dialogues in the economic, diplomatic, and security domains. People have been talking about how many such dialogues, both formal and informal, have been going on. This is what Secretary Clinton was talking about when she said in a press conference with the Chinese foreign minister a couple of weeks ago, that the two governments are working hard at every level "to build habits of cooperation and to open channels of communication." And I think those both reflect an underlying set of beliefs that become a factor in pushing the relationship in a more positive direction.

So when policy makers, new policy makers or remaining policy makers after this leadership transition takes place, are trying to think about how to move the relationship closer to an optimal position, or at least as close as we can get, they might want to think

about which of these positive factors are also useful for dealing with continued areas of tension or difficulty.

Finally, a fourth and final question, and this is obviously directly related to our topic at hand: Which of the many factors that serve to push the relationship in one direction or another – structural, personal, economic, et cetera – which of these factors are most sensitive to leadership change? They're all important, but some may become more important or more vulnerable in the upcoming months. These are also most likely, I think, to push the relationship back towards those extremes, which I think is a suboptimal position.

One area that's pretty vulnerable – I just noted it – is the possibility of setting unrealistic expectations for the new leadership and for the relationship as a whole going forward. Sometimes these can be unrealistically positive expectations. Sometimes, more likely, I think they're unrealistically negative ones. This is a very powerful rhetorical tool. People have mentioned this already with regard to the American political environment right now. In China as well, it's much easier to come up with who's the bad guy. And as much as I applauded the end of the Cold War, it became much harder to talk about bad guys and good guys, and rhetorically that's much harder for people. I think speech writers have their work cut out for them in that regard, trying to bring nuance to the situation. Pointing out bad guys and negative factors and setting unrealistically negative expectations and perhaps self-fulfilling prophecies is a very powerful tool for gaining domestic public support at certain times. So that's something really worth watching going forward, and for the governments on each side to think about how to mitigate the possibly harmful effects in that regard.

Of other factors in the relationship that may be especially worth watching going forward in the next couple of months, things that actually could really change as a result of leadership change, one is ideology. Yes, in recent years pragmatism has absolutely been prioritized. But it is possible that such a thing can change. Ideology has a very strong history in China and in the United States as well. Our political parties have fundamentally different views in many regards, and if politicians really choose to push those in one direction or another, the emphasis on pragmatism could change over time.

This is especially likely, I think, to rise to the fore when leaders are trying to consolidate their authority or when they're trying to win votes, to at least temporarily invoke higher ideals, higher principles; or in the absence of a formal ideology, invoking a form of closed nationalism, which many people have talked about today. And that can take place in both countries, I would add. This can be a powerful substitute for sober reflection on how our policy actions will affect the relationship going forward, and it can also be a powerful substitute for thinking about what the policy makers in the other country are actually thinking versus what's being invoked on a public rhetorical stage.

Another thing to look for going forward is: Who are the loudest and the most influential voices in each country? And I would add these are not always the same. The loud voices are the ones we hear first but they may not actually be the ones that matter. We've heard a

little bit this morning already about who are the actual important actors in China. And we haven't talked about this, but who are the actual important actors in the United States going forward, on a policy level?

Leadership transition is a really good time to observe changes in the relative influence of different voices in a country. Some of these voices might advocate very strongly for the bilateral relationship to be brought down more towards its floor or up towards its ceiling. But some of these voices matter only in times of transition and actually don't matter very much afterwards. I am no expert on which ones matter the most at which times, but I think it's something to pay attention to.

Some of the voices that matter at various times of course include the public. We've heard a great deal about China's social media. As far as I can tell, the actual connections between social media and the netizens and their concrete effect on policy, no one knows exactly. We think it matters but we're not yet sure how it matters. There are many, many more voices publicly available in China now than in the past, but we don't know exactly who these people are or how many of them there are, who is listening to them, and so on. In the United States our channels of influence may be slightly more transparent, and there is certainly a multiplicity of them, but their degree of influence changes very much with different administrations.

There is also, obviously, the intellectual and think tank community. And I think that someone earlier today noted that there tends to be more debate in China among that community than there does among the very high-level leadership, at least that we're aware of.

So there are questions about how much those voices matter – legislatures in both countries, particular portions of bureaucracies, and so on. So we want to think about, after the dust of this transition clears, which of these voices will continue to matter in actual foreign policy making?

After the dust of this leadership transition clears, which of these voices – the public, the netizens, the think tank communities, different portions of the bureaucracies – will matter for foreign policy making?

A final point. Something else to be watching for very closely right now is the issue of resource allocation. In the U.S. the two major political parties have fundamentally different ideas about and priorities for the ideal distribution of resources within society and within the government. In China this is probably also true, if not between political parties, among different groups of people and different bureaucracies. We assume there are debates going on about how these things will be implemented in practice, and these are things to watch going forward.

Well, I have hit my limit, as Dave is pointing out to me, so I'm going to stop here and let him open up the floor for questions. Thank you.

[Applause.]

Q&A for Session 2

ATTENDEE: I'm Jonathan Pollack from the Brookings Institution, the John L. Thornton Center. Jim, good to see you, and thanks for your comments.

Without going off in the arcane realms of international relations theory, can you not make a case that the United States is perhaps the most disruptive force in the international system today, not just related to China but related on a broader scale?

In other words, the presumption of the United States being an established power that wants to sort of keep things as they are often doesn't seem to correspond with the realities that we see as the world changes. So how would you see this, and how would you see this in the context of how China might see this?

JAMES B. STEINBERG: I think the United States is a very status quo power. I think the United States is largely satisfied with the status quo. We have a situation in which the order is largely one that we've established: that we are the dominant force, that we're not threatened significantly by anybody right now. We have a degree of security which is unlike anybody else's in the world.

We have a democracy and human rights agenda, but it's not a heavily revisionist agenda. That is to say, we are supporters of but we are not regime changers in a meaningful way. I think if you look at how we've reacted to the Arab Spring, for example, it's been supportive of but not, instigating of.

So I think, from a pure academic standpoint, as I look at the situation now, I think the United States has not a purely hegemonic position but it's a very strong position, which it would like to keep. And I think that's part of the problem, which is that inevitably the international relations system is one that changes, and therefore it is always problematic. If you like the way things are, it's almost impossible to freeze it. And at best, the challenge for a dominant power like the United States is to think about how to adapt to sustain those advantages in a changing environment.

The challenge for a dominant power like the United States is to think about how to adapt to sustain its advantages in a changing environment.

So for me, the dominant question for the United States in the international system right now is how do you bring the new powers in – and that's not just China; it's India, it's Brazil, it's South Africa, it's Turkey – in ways that are largely supportive of the enterprise that we've established but recognizes that they're going to have a more influential voice. And that's how I think we sustain an order which is largely one that we want to continue to sustain.

So I understand that there is an element in Chinese thinking that sees the United States as being disruptive, but I don't think that's supported in fact. And I think, again, the challenge

for the United States will be to recognize that we may like what we have now, but to get the equivalent of it in the future we will have to adapt to that rather than just say, by God, we just want to keep it and everybody should stay, because China isn't going to stay where it is, India isn't going to stay where it is, others aren't going to stay where they are, and that will require dynamic leadership on our part.

ATTENDEE: Wayne Ullman, U.S. Air Force.

Thanks for your comments so far, and I'd like to hear some observations about some of the recent more assertive policy things that the Chinese have done, particularly in the South China Sea, and I'm thinking particularly the establishment of the Sansha prefecture structure down there.

And the reason I ask about that is because it seems to be a fairly deliberate policy decision. And coming this close to the transition in leadership, does that indicate the future direction of the new leadership? Is it something they're kind of saddled with moving forward? Just some of your thoughts and observations on that.

JAMES B. STEINBERG: It's a great question. And one of the things that you discover – and it's especially powerful with the Chinese, for whom history is long – is that where you start the story depends on how you understand the story.

So, if you ask the Chinese – I happened to have the chance to do this in the last couple of days – about Sansha, they say, well, that's because the Vietnamese passed a law in their parliament that said that, no, they had sovereignty. So we had to respond. And the Vietnamese say, well, we did that because – and what you have is a dynamic here in which everybody is acting and reacting in a dynamic in which they're being driven by a lot of forces.

And so, the Chinese say, where did this all start? It started because the Law of the Sea apparatus required the formalization of claims at the end of 2008 and 2009, so people started making filings. And the Vietnamese made filings and the Filipinos made filings, which were inconsistent with the "indisputable" Chinese right to these things, and so they had to make indisputable claims.

I'm not trying to defend or justify anybody here. I think what's more important is to recognize that a dynamic is taking place of action and reaction among the parties, which has destabilized the situation which, around the time of the DOC [Declaration on the Conduct of Parties in the South China Sea] in 2002, was pretty stable, in which everybody decided to kind of put aside the claims and try to see if they could move forward. So the Chinese will be very vigorous in saying why what they're doing is not aggressive or assertive but reactive, and the minimum that they can do to preserve their position in the face of aggressive

[In the South China Sea] a dynamic is taking place of action and reaction among the parties, which has destabilized the situation.

actions – and, again, I'm not here to call balls and strikes on it, but I'm worried about this dynamic.

I think that the challenge now is, first of all, for the Chinese to understand that they may be able to make the case to themselves why each move they make is justified by the heinous act of others, but as a great power it's not in their interest to do that, that they have to think about a different strategy, and that they actually need to short-circuit this game because they're being manipulated by countries that are less powerful than they are and being driven into a situation where I think they're losing influence and they're running the risk of a confrontation.

I hope, especially because of the propitious timing, that the East Asia Summit will come after, hopefully, both transitions, that we have an opportunity at the EAS for everybody to step back to look at some of the ideas that ASEAN came forward with in terms of the DOC and the Code of Conduct, and actually get this back on a more constructive tack.

But I think that it's less important to label who's being aggressive and who's being responsive and to recognize that China has an interest and a responsibility to step out of this tit-for-tat mode that it's gotten itself into and to think about its longer-term interests and the consequences for its relations with its neighbors and the United States for the style of kind of incremental policy making that seems to be going on there.

It's less important to label who's being aggressive and who's being responsive and to recognize that China has an interest and a responsibility to step out of this tit-for-tat mode it's gotten itself into, and to think about its longer-term interests and the consequences for its relations with its neighbors and the United States.

DR. DAVID FINKELSTEIN: We're going to take two questions.

ATTENDEE: Thank you both. Philip Lin from T. Rowe Price.

One of the governing principles, as enunciated by the Chinese government, for Sino-U.S. relations is that each side must respect the core interest of the other side. And the Chinese government has defined its core interest as including Dalai Lama issue and, you know, Taiwan, and so on and so forth.

It is unclear to me whether the current dispute between China and Japan over the Diaoyu Island is part of its core interest. It would seem to me to be logical that that is included. If that is the case, if you are advising the U.S. government, how would you advise our government to act in this dispute? Thank you.

ATTENDEE: Paula Stern. Well, mine is completely on a different spectrum here, and it relates to something that Ken had brought up earlier about resources, environmental challenges in China, everything from water to waste being a problem, and the fact that we've got this silly trade war – which, frankly, was predictable – on, of all things, solar and

wind, areas where the U.S. and China had tried to lay out, from the very beginning, areas of really fundamental collaboration.

So my question is, is there a way to address the opportunities that are so fundamentally important to China as well as to the United States, given climate change, to put this on an even higher level, because we started out well but we're ending up in a terrible situation, and the new leadership, whether it's here or in China, is going to have to tackle these problems. So, you know, do we have the wrong structures going on here, do we not have the right leaders addressing these problems?

JAMES B. STEINBERG: Well, Paula, it's a great question. And, you know, I do think a lot of people feel, that there has been a disappointment on an agenda of energy and environment which ought to be a great opportunity for cooperation and collaboration, that we have made far less progress than I think many had hoped.

But I'm not going to excuse the Chinese on this, because I do think these issues of IP [intellectual property] are enormously important, and I think the Chinese have behaved badly. I think that there's a rhetorical commitment to it which is not backed by action. It's not only important as an economic issue in the United States, but a key constituency in the United States that ought to be supportive of the U.S.-China relationship is being undermined by this very, very narrow-minded, short-term venal action. I know a lot of the companies that are in this space and who really wanted and have been advocates for good relations with China, but I find it very hard when they see the whole future of their companies being undermined by a system in China that is just deeply disrespectful of that.



The audience at the Ronald Reagan International Trade Center

So I think it is time that the Chinese leadership understood that this is an important part of sustaining the relationship. And you can argue about certain things – I mean, about subsidies and the like. All right. I disagree. There are different models and we'll have those fights, but IPR theft is unacceptable.

And so much of the reason we're not getting collaboration in the space, because of so many things like that, is simply that that fundamental commitment that the Chinese need to make isn't being done. So I think it is unfortunate. I think there are great opportunities. And I think it does require leadership at the top, but the most important thing is for the Chinese to understand that this is so damaging to the relationship. And there are clearly short-term economic gains that the Chinese get from it, but there are big costs too.

The core interest question is an extremely complicated question, and the reason is because at the heart is something very important in the future of U.S.-China relations, which is that we will succeed or fail in managing this relationship depending on whether we can find a space in which we feel that each side can pursue a policy that protects fundamental national interests that one side believes in, in ways that don't threaten the fundamental interests of the other.

But for that to work – I mean, it may not work at all because it may just be that they are so misaligned that circles don't overlap. But there's no chance of it working if each side elevates everything that it cares about to being a vital national interest or a core interest, so that then it makes it harder and harder to find that overlap zone.

We will succeed or fail in managing this relationship depending on whether we can find a space in which ... each side can pursue a policy that protects fundamental national interests ... in ways that don't threaten the fundamental interests of the other.

And what is worrying to me – I mean, sovereignty – we've got the expert in history here. We've heard about the century of humiliation. Anybody who's dealt with China knows how important sovereignty is to China. And the United States, for 40 years, has understood the Taiwan problem in that context and tried to manage it in those terms, and has tried to manage the Tibet problem in those terms, right, in terms of respecting China's sovereignty claim over Tibet.

But what we're seeing now is kind of an inflation of every issue to being a sovereignty issue, and therefore touching China's core interest, which is making this all harder, you know? I mean, if it's a sovereignty issue and cannot be compromised, and the Diaoyu/Senkakus becomes that, and the Yellow Sea becomes that, and the South China Sea becomes that, then the possibility of achieving that fundamental strategic equilibrium that I think is so important becomes almost impossible.

So, part of the reason we've stopped talking on both sides of our core interest is because for that to be a useful concept in the relationship, both sides have to be really serious and say, look, there are some things that are bottom lines for us and you better find a way to deal with it.

And I think when that list was relatively narrow, and largely focused on Taiwan and Tibet, we did a reasonably good job of trying to both respect our core interest, which is not to let China use unilateral force against Taiwan and things, but in ways that also were sensitive to China. But if we're going to find out that everything becomes a core interest for China, then the relationship is in big trouble.

DR. ALISON KAUFMAN: Just a very, very brief comment on that is, I think one of problems with discussing national interest is that it's really hard to find that sweet spot between being too vague and too specific.

Maybe in recent years China has been rather specific about what fits into that box. And the U.S. is on the other hand often somewhat vague when we talk about Global Commons and other things like that, but there are a lot of things, I think as Dean Steinberg pointed out, that can fit into those boxes. And it's hard to define those, and a new administration may be especially interested in trying to define them in ways that may not be very productive.

On the other hand, you also have seen, within the last few years, a definite change in some areas, such as – the Chinese government would certainly say that the issue of noninterference in domestic affairs is a core principle, and yet there have been changes to policies on issues like U.N. peacekeeping and other things like that, suggesting that the principle has room for movement on the specifics.

And thinking about national interests in that way as well, to say there are certain principles that both countries have great interest in upholding, and they differ for the two countries, but there may be room for movement on specific issues within those –both countries I think have shown that in the past.

DR. DAVID FINKELSTEIN: Please join me in thanking this panel. Jim, Alison, thank you.

[Applause.]

Luncheon speaker

Mr. James Fallows, *The Atlantic*

Takeaways – Mr. James Fallows

- The media's portrayal of China tends to be dichotomous: either an economic juggernaut or a broken system on the verge of collapse. Both of these are inaccurate pictures.
- Instead, the media needs to reflect the ambiguities inherent in China's rise.
- Nationalism is a force that can unite disparate groups within China in opposition to a perceived foreign aggressor.
- The best way for the American public to understand the complex situation in China is for them to travel, work, and study there.

JAMES FALLOWS: I feel some chagrin for what I am going to try to say. The chagrin is not being here en route to Dulles Airport, always a heart-sinking operation for any of us, but rather knowing, as I look around the room, that all of you are the kind of people I would go interview to do articles, and most of you, I actually have gone to interview. So I am in the position of the journalistic amateur addressing the professionals who are the experts on the subjects I often try to write about. So what I am not going to try to do is to tell you in any detail things about the Party Congress or about the various political transitions in China. Instead, I am going to try to raise a meta issue with you about the way experts like you work through intermediaries like me to deal with the public at large and how the kinds of uncertainties that you weigh as you decide what is going to happen with the Party Congress, what's going to happen 2 years from now, 10 years from now, how they are translated into popular feelings about China, political decisions, and all the rest.

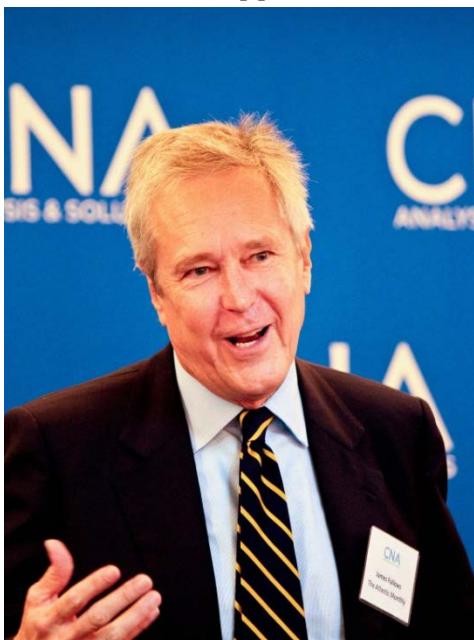
Something that has been on my mind constantly and now these 6-plus years since my wife Deb and I went to China – we spent about 4 years of the last 6 there and a lot of other time going back and forth – is how to connect the American public, which would rather not think about foreign topics at all and, if it does think about them, would like to have very clear black/white-, good/bad-, war/peace-, success/failure-, friend/foe-type distinctions, how to get them to deal with the modern phenomenon that is most resistant to that black/white thinking of how things are going on in China.

There is a subsidiary part of this which then will lead to the main part, which is that I've been impressed, in trying to write to an informed public at *The Atlantic*, with the ripple effects on a broader public of dealing with this ambiguity.

One of the sub-problems is the tendency by many Americans, including some in the press, to grossly exaggerate China's successes, its omni-competence, the unstoppable juggernaut-like nature of its political and economic progress. A month ago in *Newsweek*, there was a huge cover story that was based on a chart showing China's economy unstoppably and certainly surpassing that of the United States in 3 years or 4 years or whatever. This was an argument for the failure of the current administration to not stop this phenomenon in some way. We all know that China at some point will have a per capita income greater than one-quarter of America's, and at that point, it will have a GDP larger than ours. But we also know the various uncertainties about when that will happen and to whom the benefits will be distributed in China. That is not often conveyed to members of the public.

Many Americans grossly exaggerate China's successes, its omni-competence, the unstoppable juggernaut-like nature of its political and economic progress.

I think the Chinese did themselves a great disservice in the staging of the Beijing Olympics, which obviously was meant within China as a manifestation of power and seamless competence by the government, but was taken by many viewers around the world, especially the opening ceremonies, as just warning the rest of the world that it should give up, there was no way to compete with the kind of precision and scale people were seeing in the opening ceremony. Even today, you will read in the *New York Times* an influential op-ed column about, on the one hand, success of foreign education in China and, on the other hand, what the writer actually says, the lack of creativity in the DNA of Chinese students. It is quite an extraordinary claim to be made in a column. So we have this background sense of Chinese unstoppable omni-competence, which I think is actually a projection of fears in the U.S. about ways in which we are faltering.



JAMES FALLOWS, *The Atlantic*

There is the larger issue that shapes everything you do, everything politicians do, and everything that reporters like me do in trying to explain this phenomenon, which is making Americans comfortable with living with ambiguity and with unresolvable ambiguity for as long as any of us are going to be on this beat, that we are not going to know what China is going to be when it grows up, because it is going to continue growing up, and things are going to be surprising to us. So that is something I think about a lot, of how to convey the fact of recognizing the unanswerability of many of the questions about China and positioning ourselves to be comfortable with that unknowability and having policies that will live with it.

In my newly published, widely praised book, *China Airborne* –

[Laughter.]

JAMES FALLOWS: – it's all about this question of how we are able to recognize we don't know what is going to happen. I am going to spend a couple of minutes giving some details of ways in which the ambiguity of outcomes in China is the most important fact and then suggesting how Americans and other outsiders can deal with that on a policy level, on a business level, and on a public level, and then I will have a rousing conclusion and then a few questions and answers.

At the most immediate level, of course, there is the immediate political stability question in China: Where is Mr. Xi? Where is Mr. Bo? Where are these people? What is happening to them? Who is going to take over? I know you have been discussing that this morning. Has Xi Jinping been seen since this morning or not?

DR. DAVID FINKELSTEIN: He was supposed to be the luncheon speaker, but –

[Laughter.]

JAMES FALLOWS: That's how I got the gig. There was an opening.

There's the [problem of] finding some way to convey to the public what matters and doesn't, about the things we know and don't.

So I think that this has been somewhat useful for the public in having a sense of if there is this Huey Long-type drama in Chongqing? That suggests something about the factional tensions in China and the human passions involved there, that it's not all just faceless bureaucrats.

The uncertainty about what's happening with Xi Jinping, I think also is penetrating somewhat into the body politic, recognizing that this is a succession process in the world's most populous country that resembles, in the entire world, only that of the Vatican. That's the only thing which is a comparably opaque succession process to China's, while we're having our own here. So there's finding some way to convey to the public what matters and doesn't, about the things we know and don't and the personalities. That is sort of the most immediate issue.

A second issue, also involving politics, is the next scale up in political uncertainty or stability, which is essentially the robustness of the political system in toto. I find Americans who have not spent time in China tend to polarize themselves into either thinking there is seething discontent which is going to burst out at any second, just as it did in Eastern Europe, just as it finally did in the Soviet Union, just as it did in the Arab Spring, and so it's only a matter of time before we have that kind of civil society revolution; and another group of people saying, "Well, as long as the standard of living is going up, as long as people feel as if China has its place in the world, the Party can maintain its hold for a long time." And you all know that both of

Americans who have not spent time in China tend to polarize themselves into either thinking that there is seething discontent which is going to burst out at any second ... and another group of people saying that ... the Party can maintain its hold for a long time.

those things and a thousand other things are all simultaneously true. So finding a way to address the unknowability of the system itself – I've spent some of the last 2 weeks talking to people who are really expert on these issues, like many of you, and there are diametrically opposed points of view on it.

Next, the economic balancing question. Over the last 5 or 6 years, like you, I have been to session after session and heard speech after speech about the great rebalancing that is about to take place in the Chinese economy, between consumption and savings and exports and imports and balance within the income distribution, and that remains as thorny a problem now as it has been over the last 4 or 5 years; if anything, thornier, I would think, because of political uncertainties. Whether China will be able to have an easier evolution out of the infrastructure-led, export-led, investment-led growth model to something else, I don't think any of us knows that, and conveying to our publics what that means, for their stock portfolios, for their unemployment rates, for their investments is important and difficult.

Whether China will be able to have an easier evolution out of the infrastructure-led, export-led, investment-led growth model to something else, I don't think any of us knows – and conveying to our publics what that means ... is important and difficult.

The question I deal with most in this book is the next one, which is about the evolution of the Chinese economy. It strikes me that most press reports of China's development in the U.S. assume that what we've seen in the last 30 years is prelude, if anything, to an accelerating growth the next 30 or the next 60 or the next 90 when you'll have this Chinese colossus that will own everything and produce everything. And you all know that in the last 30 years, we have seen one kind of economic miracle, the conversion of hundreds of millions of peasants to the Keynesian-style, low-wage industrial workers, and we don't know about the next stage, whether there is a possibility of going from subcontractor to Apple to having your own Apple, doing localization of GE to having your own GE, having all the high-value components that make for a really rich economy. I argue in this book that it is going to be quite hard, and that there are more reasons to be pessimistic about that transition than to be optimistic about it, but it is one, again, that has profound implications for us on the commercial level, on the diplomatic level, on all the other aspects of western dealing with China.

Next, on the area of crucial uncertainties, where the challenge is living with the goods and the bads, is in the field of the environment. I have often argued, and still believe, that the environment is China's worst problem and also the worst implication China's growth has for the world as a whole. But I wrote an article 3 or 4 years ago in *The Atlantic* saying it's a switch hour by hour and day by day between marveling at how terrible the environmental situation is in China and how hard they are trying to deal with it, and so it is a race between these two factors of really dire situations that I don't need to belabor for you, but also more purposeful addressing of them in many ways than we have seen in other parts of the world. And so that balance between how fast things are getting bad and how hard people are trying to keep them from getting bad is significant.

Next in the realm of important ambiguities that affects many of you in this room is the military ambition of China. By my observation, I have ended up in the dove camp about the military threat from China. Largely, that's from seeing the actual level of Chinese military equipment, readiness, doctrine and all the rest now. Partly, it's from reflecting on the fact that the People's Liberation Army contains hardly any combat veterans. The U.S. is always at war, and so we always have trained and tested troops and weapons and all the rest. China has not been at war for many decades, when it did poorly against Vietnam. That says good things about China in many ways, but it also says other things about military readiness. But I know that for people in this room, a lot of your plumbing of uncertainty is whether that's a misleading guide to what's ahead, the capabilities that are arising, what might change the abilities of the Chinese or their intentions, the entire spectrum of military conflict, including the cyber realm and all the rest. I think this is also a difficult issue for many lay Americans to deal with, because they assume axiomatically that a rise in national dignity, national power, and national economics comparable to China's just must inevitably lead to military conflict, and it might well in the South China Sea. It certainly could in Taiwan, as you all know.

One of the most powerful and damaging mental models here is one I have often encountered on debates in this subject by people who contend that the rise of China now is most similar in world history to the rise of the Kaiser's Germany in early 20th century. To me, that seems preposterous; these similarities between the Kaiser's Germany and 21st century China are about 1 percent of the differences between modern China and Germany of the early 20th century, that led to an apparently inevitable, although unintended conflict with the British, but this is a mental model, and these things have tremendous power in shaping people's instincts and reactions.

Because there is not any model for what's been happening in the last 30 years between China and the United States and what might happen in the next 10 or 20 years, it is harder to convey to people how this might be different from the build-up to World War I, but I often encounter that image and is one I try to argue against.

Next on the list of important uncertainties is the role of nationalism, an important factor around the world, notably in the United States. I was struck by nationalism in China in this particular way. Ninety-eight percent of the time, I was impressed by the diversity, centrifugal forces, chaos, and differences within China, regional differences, factional differences, language differences, business differences, clan wars of any kind you want. As I'm sure you all, many of you here, have written about those things, it strikes me as a whole assemblage of humanity that sometimes masquerades as a country.

Many Americans ... assume axiomatically that a rise in national dignity, national power, and national economics comparable to China's just must inevitably lead to military conflict. ... There is not any model for what's been happening in the last 30 years between China and the United States and what might happen in the next 10 or 20 years.

Ninety-eight percent of the time, I was impressed by the diversity, centrifugal forces, chaos, and differences within China The two percent of the time when I have had the opposite feeling is when there was some perceived slight to Chinese dignity, ...which had an unwholesome power to unify people into thinking we Chinese versus you westerners.

The 2 percent of the time when I have had the opposite feeling is when there was some perceived slight to Chinese dignity, some western disrespect to China's achievement, to China's equality, to China's rise in the world, and it struck me that that had the power, and an unwholesome power, to unify people into thinking we Chinese versus you westerners, you Americans, you Brits, you Japanese, and all the rest. Conveying to our publics and our political leaders both the chaos and diversity and the potential unity, I think it's a different kind of challenge from what we have in many other parts of the world and one that is worth our concentrating on and thinking about.

ambiguities is the generational one. In any part of the world, generations have their significance. My parents' generation is revered by everybody as the greatest generation. My generation of the baby-boomers, hated by everyone. The next generation of my kids, we hope for better from them, although my observation is that people of my kids' generation, their early 30s, all of the passion that once might have gone into political activity or the theater or literature is now all in food. We have a generation of foodies.

[Laughter.]

JAMES FALLOWS: So we have the greatest generation, the baby-boomers, and the foodies. This might be the decline of America. I don't know.

So, if this is true in America, I am just dumbfounded by how powerful it is in China, because the historical experience of the living memory of anybody now in China has been so starkly different in these 5-year bands. People in their 80s have seen things no one in America has seen. The people now in the leadership generation have been through a kind of hardening process that their American counterparts largely haven't. People who are 30 or below have a different sort of upbringing, different gender relations, different economic expectations, and all the rest.

There is an argument, I have heard, by many people in China, that the experience of this younger generation will necessitate the evolution of China into a more civil society type of place. I actually had a chance several days ago to interview, for *The Atlantic*, Chen Guangcheng on this point, and he was arguing that the process towards a more constitutional rule of law society in China was inevitable, just because more and more people knew about the circumstances, the rest of the world, et cetera.

You know people who argue the opposite case, that the sensitivities of the young people are the more sharply attuned. Until now, I argue, it has been generally a force for international goodwill that so many Chinese people have come to the United States and the

western world. They have generally liked the experience. They have generally gone back with some sort of westernization of their views and values. That's been a good thing. It is possible, however, that for a younger generation, their foreign exposure could have the opposite effect. They could say these people are decadent, these people are bigoted, these people can't do their own business. So knowing how this next generation of people will feel about their country, its place in the world, and our place in the world is an important ambiguity.

To wrap up this part and then to move towards the big finish – yes, I was once a speech writer. I was a speech writer for a man famed for his terrible speaking.

[Laughter.]

JAMES FALLOWS: So it all balances out.

Everything in life is unique, of course, and to say that the relationship between China and the United States is unique is a banal thing to say, but it is really uniquely unique. It's an especially difficult circumstance, because the historical models are so either misleading, as with say Japan's rise in 1930s, Germany's rise in the 1910s, or non-available. The United States does not have experience with a peer competitor.

And the United States' rise to being the leading economy in the world a hundred years ago is not really a parallel, either. The political system is different. The immigrant makeup of the country is different, et cetera, too. So we have a challenge, you all in finding expert knowledge, and all of us in our role as middle man to the public and our political leaders – in finding a way to make American people comfortable with not knowing, because we are not going to know the answers to any of these things. We are going to keep triangulating them year by year, month by month, but we are not going to know where they are going to continue to change. And so that, I view increasingly as the challenge of having people live with uncertainty in a more comfortable way than they can usually do.

We have a challenge ... in finding expert knowledge, and in our role as middle man to the public and our political leaders, in finding a way to make American people comfortable with not knowing, because we are not going to know the answers to any of these things. We are going to keep triangulating them year by year, month by month, but we are not going to know where they are going to continue to change.

What then do I recommend to you, the expert community? And I say this also to the non-expert community. I think the most important way to make Americans in particular comfortable with this unknowability is to give them firsthand experience in China.

If you talk to somebody who has been teaching in some rural province for 2 years or trying to do business in Chengdu, or whatever, that person, if you ask him, "Oh, is China about to take over the world?" or "Is China about to collapse?" he will probably laugh at either one of those, because he has seen contrary indications on both sides.

I think the most important way to make Americans ... comfortable with this unknowability is to give them first-hand experience in China.

The genders in our world, they don't perfectly understand each other, but women have a sense of the range of behavior in men and men have a sense of the range of behavior in women, because we are exposed to each other. I think by analogy, the more we can expose Americans to the wrinkled reality of today's China, the greater the chances that they cannot succumb to simplistic, either good or bad, pitches from political leaders, not be suckers for journalistic

arguments that things are all great or things are all terrible in China, and recognize that just as dealing with our own continental expanse is full of its contradictions and its pluses and its minuses. That's the challenge for us, as the leading power of the moment, in accepting the rise of another huge power that has strengths and weaknesses and being prepared for the things that might succeed and might fail in China.

So that is my pitch. I am making a virtue out of the fact that I know less than all of you by saying that knowing less is the reality for everybody, and that none of us knows enough. We are all going to try to incrementally see into the darkness, but recognizing how short the distances our headlights penetrate is the most important part of our policy.

So that is my story. I'm sticking to it, and I'll be happy to answer any questions or complaints that you might have.

[Applause.]

Q&A for Luncheon Speaker

ATTENDEE: Just to set some context, we have heard this morning a pretty dire prognosis about water in China. You have referred to the environment as a, quote, "mess," urbanization, rural depopulation, and indeed, you are referring to – I might get away with it – my generation as a bunch of "foodies."

Somebody once said we're four meals away from anarchy. So my question is quite simple to you, sir. How does the incoming fifth generation feed over a billion mouths?

JAMES FALLOWS: I think that an impressively competent part of the Chinese leadership over the last 30 years has been addressing whatever is the emergency of the moment. Another of the models I have for the Chinese leadership is a raft going down an extreme whitewater rapid passage, and in just the last second, they avoid each boulder. And there is another one, but they steer around that as they come to it. And as food shortage becomes the emergency of the moment, I have no doubt that the resources of the system will be addressed to that problem.

An impressively competent part of the Chinese leadership over the last 30 years has been addressing whatever is the emergency of the moment.

But taking that not in its limited form but in its broader form, I do think that although I am optimistic by nature, I am less optimistic when I confront environmental situations in general. And the tension between the completely legitimate and unstoppable Chinese and Indian desire for more material goods of all kinds with the resource limitations of all kinds in the world, whether it's just food or the general climate consequences and carbon consequences. So I think I wouldn't expect famine in the near term in China, because I think the system will do everything it can to avoid that, but all the consequences of averting it, and just the strain on the world environmental system to me is the emergency of the day. And I don't have a promising answer beyond that.

ATTENDEE: Hi. My name is Zhu Xiaodi, Deputy Director at the Ames Foundation for Education and Culture Exchange. I cannot agree more with your last point about having more Americans living or teaching in China. In fact, the mission of my office here is try to mobilize or solicit 150 U.S. teachers to teach in China next year and 500 U.S. college graduates to teach in China next year. Now I am soliciting your advice on how can we achieve our mission.

JAMES FALLOWS: Congratulations on doing that. I will give one brief background before coming back to your question again. Something I also describe in this book and that really impressed me when I was traveling around China is the many, many, many layers of connection between the U.S. and China. You have the presidential visits, and then you have all the sort of departmental collaboration between the Energy Department in the U.S. and its counterpart in China. But then every place you go, there's somebody who has a cousin at Michigan State or someplace where a Peace Corps teacher has been or somebody where a

factory representative from Akron came in there or the Rotary Club fellowship. And I think this has a profound effect in making a multi-stranded connection between China and the U.S. So I am very glad you are doing that.

I think the main way in which the wind is at your back in promoting this is that many ambitious American families would think that learning Chinese and experience in China is a plus for their children, and so there has been a huge increase in Chinese language studies in the U.S., of course not enough but still an increase.

My wife, who is a linguistics person, published a great book called *Dreaming in Chinese*, about what you learn about China by learning Chinese language. So she's been going all around the country talking to these language programs.

I think that while you do your admirable work in finding financial support for your operation, I think that, fortunately, many families will think it's in their self-interest, too, to be involved in that way. So it is easier for you to do this than, say, to get teachers in Sudan right now or something, which would be a pure sort of philanthropic as opposed to something that also seems self-beneficial, so good luck.

ATTENDEE: Ambiguity in China is just the tip of the iceberg. What you really could be saying is that the United States has to learn to live with ambiguity about everything. You are in the middle of it on a million fronts. Talk about China as opposed to the larger American dilemma.

JAMES FALLOWS: You are certainly correct in saying, I am mentioning a banal and obvious point about the world in general, but I think it has particular heft about China, because the mental model many Americans have in mind is the centuries-old one of the menace from the East, which has been in popular imagination for a long time, the recurrent American fear from Sputnik and the Japanese, of national decline relative to some foreign power, the older American fear than that of our system running out of steam, and the natural tendency of any large continental people to be inward looking, this is how big countries are versus Belgium or Holland or whatever else, and so it's hard to know about things in nuance.

Since you all were at this conference this morning, you have not been hearing the news in the last couple hours about the Libyan tragedy where the U.S. Ambassador was killed, I will just describe two statements.

President Obama and Secretary Clinton appeared and made a very sober statement about how America owes a tremendous debt to the people represented around the world; that they take tremendous risks, and this is a tiny sign of the risks people are taking everywhere; that America stands for complete toleration of religion, but, of course, there is no excuse for violence of this sort. And they said since some of the next of kin of some of these victims are not yet notified, we are not going to name them all, but just a very sober statement by the two of them.

Their opponent, Mr. Romney, gave a speech blasting Obama for apologizing for America, and – I am not at the moment making a partisan point. I am making a point that relates to sort of the recognizing the complexity of the world, and not everything is about the next opinion poll in Ohio. It is hard for Americans to get beyond that.

I'd recommend to all of you seeing the contrast of the two statements. To talk politics for a moment, I think that this will be a really destructive moment for Mitt Romney, because it was a 3 a.m. phone call where he felt he had to respond immediately and responded in a very partisan way. So we will see how it turns out. In a way that he wouldn't do in business, I think, but anyhow, that's a way of answering your question that it's hard in the entire world to do.

There are sensitivities with Mexico and with the Arab world and with Africa and all the rest, with Europe, but I think it's particularly acute in China, number one, because that's where I've been, so it's interesting to me, and number two because of the scale. The cliché is that it is a crucially important relationship, and it is. It's not inevitable that the last 30 years would have gone as well as they did between the two countries. It's the credit of many of you in this room they've gone as well as they have. It's not inevitable they will go as relatively well the next 30 years, but it's worth all of our making that happen. So it's Wilhelm I in Germany or some other ominous model.

It's not inevitable that the last 30 years would have gone as well as they did between the U.S. and China. ... It's not inevitable that they will go as relatively well the next 30 years, but it's worth all of our making that happen.

DR. DAVID FINKELSTEIN: Jim, I want to thank you again for making time in your schedule to do this.

I wrote down on my piece of paper "Conveying to the public what matters about China and what doesn't," and I can't think of a better banner for CNA China Studies to take up that challenge and do our best to continue to do that, along with other colleagues in the room who represent all the experts that you sit in awe of, and as well you should. So thank you so much.

[Applause.]

JAMES FALLOWS: And thanks for the help that many of you have given me over the years when I've come to interview. I really appreciate it.

Session 3: What's at stake for U.S. business?

Panel introduction: Dr. Jeffrey Becker, CNA China Studies

DR. JEFFREY BECKER: Good afternoon. My name is Jeffrey Becker. I am a China Analyst at CNA, and I have the honor of introducing our next panel this afternoon, which will examine what is at stake for U.S. business on the eve of the 18th Party Congress.

For many U.S. firms, China is often described as a dynamic and rapidly changing environment in which to operate. Yet despite this fluidity, there are a number of issues that have remained areas of concern for U.S. firms over the year. Unclear, inconsistent regulations, opaque legal environments, infringements on intellectual property rights – these are all consistent issues that face U.S. businesses operating in China, and they have been sources of tension for a long time.

While the specific nature of these complaints has changed throughout the years, all have been reoccurring issues for U.S. businesses in China. How will China's new leadership manage these and other longstanding issues in its relationship with the U.S. business community, and how will these issues affect U.S.-China trade relations?

China's new leadership will also face a host of relatively new economic issues as well, that demand their attention in the process of this leadership transition. While the Chinese economy seems to have engineered a soft landing emerging from the 2008 economic recession, the new leadership will be racing against prospects of a prolonged economic slowdown with double-digit growth unlikely to return in the near term.

At the same time, the new leadership will continue to struggle with restructuring the Chinese economy, which we discussed to a certain extent this morning, transitioning away from an over-reliance on exports toward a greater focus on domestic consumption. While some of that in social welfare reform, implementation of social insurance laws, medical reform, and pension is already underway, other issues in terms of financial reform have been more intractable.

So to discuss these issues and explore this idea further about what's at stake for U.S. business in China, we are very pleased to have with us today Ambassador Carla Hills and Mr. Nelson Dong.

Ambassador Hills is Chair and Chief Executive of Hills & Company, international consultants, which advises companies on global trade and investment issues focusing on emerging markets. Ambassador Hills served as U.S. Trade Representative from 1989 to 1993, in which capacity she was President Bush's principal advisor on international trade policy. Ambassador Hills also served as Secretary of the U.S. Department of Housing and Urban Development in the Ford administration. She previously served as the Assistant Attorney General, Civil Division at the U.S. Department of Justice. She serves on a number of

corporate boards. She is Vice Chair of the National Committee on U.S.-China Relations, the U.S.-China Business Council, and the Inter-American Dialogue.

Mr. Nelson Dong is a partner at Dorsey & Whitney LLP on their corporate group. He represents technology companies and venture capital financing, technology transfer and distribution agreements, and other domestic and international technology and international property transactions. Mr. Dong has substantial experience in consulting for e-commerce, semiconductor, electronics, computer, and biomedical and biotechnology companies. He has special expertise in domestic and international technology licensing, manufacturing in Asia and U.S. export control matters. Mr. Dong writes frequently on a number of issues germane to U.S. businesses operating in China, including international property law, U.S. export control law, and technology-related business transactions, among many other issues. He has lectured on these topics throughout North America, Europe, and China. He was Assistant U.S. Attorney in Boston, Deputy Associate Attorney General at the Department of Justice, and White House Fellow and Special Assistant to the U.S. Attorney General.

And so CNA is very pleased to have both of our speakers here to speak to us today about this issue, and with that, I will turn it over to Ambassador Carla Hills. Thanks very much.

[Applause.]

Speaker: Ambassador Carla A. Hills, Hills & Company

Takeaways – Ambassador Carla Hills

- The key questions in the U.S.-China economic relationship are: (1) Does the economic relationship provide sufficient ballast to move the overall bilateral relationship forward? And (2) Are there specific actions that government and private sector can take to help propel the economic relationship forward?
- China is a critical trade and investment partner for the United States.
- There are three major challenges in the U.S.-China economic relationship: a fragile global economic environment, a trust deficit, and a knowledge gap.
- More high-level contact, stronger IPR laws in China, and more bilateral cooperative efforts can help alleviate these obstacles and improve the relationship.

AMBASSADOR CARLA A. HILLS: Thank you. Well, thank you, Jeff, and I congratulate David on putting together this conference. I also congratulate you on your 70th anniversary.

We have heard a lot this morning about the fact that this year, we will see leadership changes in both the United States and China. You know, here in the United States, even if President Obama is the winner of the election, Secretary Clinton, Secretary Geithner, the Trade Representative, and indeed the economic team will change, and so, too, if Governor Romney wins the election, he'll bring in a whole new team. And in fact, there will be some delay because confirmations traditionally take a long time.

And at the same time, the 18th Party Congress in China will experience its once-in-a-decade leadership transition. Xi Jinping, currently Vice President, is expected to be elevated to the presidency. We have heard about the changes in the Standing Committee this morning, and the Politburo. So there will be a lot of new faces that have to interact, and without speculating on the leadership outcomes, David asked us to take stock of the current state of play in relationship to the bilateral economic relationship and to explore what is at stake for U.S. business in China, a nation that comprises 20 percent of the world's population.

Leaders on both sides of the Pacific have said about the relationship between the world's two largest economies, it is going to shape the 21st century. When Vice President Xi was here in Washington this past February, he was quoted as saying that the Sino-American economic relationship, is the ballast and propeller for the overall bilateral relationship, and so that raises two questions, whether our current economic relationship provides sufficient ballast to enable the leaders of the world's two largest economies to move the bilateral relationship forward in ways that will expand opportunities for our businesses and thus prosperity for our people; and secondly, whether there are specific actions that our

government and the private sector could take now to help propel our economic relationship forward or, alternatively, to cause it to veer off course.

So let's start by looking at what China means to U.S. business. We have witnessed enormous change with respect to trade and investment in China since it joined the World Trade Organization a decade ago. As a result of market openings required by its WTO accession agreement, China has cut tariffs by more than 40 percent, eliminated many import licenses, relaxed ownership restrictions on foreign businesses, and permitted foreign companies to compete in sectors that previously were closed to them. And as a result of these market openings, China has become the world's second largest recipient of foreign direct investment. Its trade has exploded. It has created jobs and raised income, and it has generated growth. So today, China is the world's second-largest economy and its largest exporter, and over the past 2 years, it has contributed about 16 percent to global GDP growth.

Since China joined the WTO, it has cut tariffs by more than 40 percent, eliminated many import licenses, relaxed ownership restrictions on foreign businesses, and permitted foreign companies to compete in sectors previously closed to them.



AMBASSADOR CARLA A. HILLS, Hills & Company

Our trade relationship is robust. The United States is China's second largest export market, just behind the European Union, whereas China is the America's fastest growing export market and is currently its third largest, behind Canada and Mexico. In the decade since China joined the World Trade organization, U.S. exports [to China] are up more than 500 percent, which is by far the fastest growth that America has experienced with any of its trading partners, and its benefits have been felt nationwide. Forty-eight states report that their exports to China have tripled in that period, and nearly half of those reporting state that

they enjoy a fourfold increase. China is the only major U.S. export market that has provided the growth rate needed to meet President Obama's goal of doubling U.S. exports by 2014.

In addition, U.S. investments in China are doing quite well. Eighty percent of the companies responding to a survey conducted in 2011 by the U.S.-China Business Council reported double-digit revenue growth for the year, with half reporting a fourfold increase in their revenue growth. A majority of the respondents said they experienced higher growth in China than in their worldwide operations. The fact is that our economies are complementary. China has a huge market of 1.3 billion people that is in the midst of a rapid urbanization that will continue to benefit from foreign investment and leading edge technology. The United States is an industrialized economy with strong capabilities in technology, management, market skills that can facilitate China's continued economic advancement.

So what are the challenges? With substantial progress being made with respect to trade and investment, there are problems. Let me address three that are in some degree interrelated: the fragile global economic environment, lack of trust, and a knowledge gap.

Today's fragile global economic environment adds to the difficulty of maintaining and advancing a strong economic bilateral relationship. Slowing economic growth inevitably stokes economic nationalism, and both countries are affected by this. The IMF in its July 16th *World Economic Outlook* downgraded the 2012 global GDP forecast for both China and the United States, stating that in the past 3 months the global recovery, which was not strong to start with, has shown signs of further weakening. At the same time, the world is experiencing a slowdown in the growth of trade. According to the April forecast of the World Trade Organization, 2012 global trade will grow by just 3.7 percent, down from 2011's 5 percent trade growth, which was in itself a sharp deceleration from 2010's trade growth of 13.8 percent. Trade, a proven motor of economic growth, has been constrained not only by the sovereign debt crisis, supply chain interruptions in Thailand and Japan, and the turmoil in the Arab countries, but also by protectionist measures, most of which have been designed to circumvent WTO rules.

Today's fragile global economic environment adds to the difficulty of maintaining and advancing a strong economic bilateral relationship.

A WTO report released at the end of April documents that just since last October, the Group of 20 economies, which account for the vast majority of global economic output in trade, added 124 new trade restrictions, notwithstanding their leaders' repeated pledges not to have protectionist measures. The accumulation of these restraints since the fiscal crisis hit

adversely affects 3 percent of global imports and 4 percent of the G20 trade. Both China and the United States have contributed to this counterproductive trend, causing voices on both sides of the Pacific to wonder whether our increasingly competitive economies plus the differences in our histories, culture, and governance are too great to enable us to harness our respective strengths to deal with the bilateral and global issues that confront us today.

Since last October, the Group of 20 economies ... added 124 new trade restrictions, notwithstanding their leaders' repeated pledges not to have protectionist measures. ... Both China and the United States have contributed to this counterproductive trend.

Secondly, a trust deficit between our two nations has been growing, and that erodes the ballast needed to keep our bilateral relationship on a steady and

positive course. Recent polls taken in both China and the United States reflect a sharp lack of trust on both sides, even though both sides are of the view that the economic relationship with the other is important. Chinese are concerned that America is seeking to prevent their nation's rise. Americans are concerned that China is seeking to dislodge the United States as a global leader by stealing its technology and discriminating against U.S. economic interests. This erosion of trust has not been helped by the political rhetoric on

the campaign trail here in the United States, which has been quite sharp and often engages in the blame game.

In addition, a number of Members of Congress, as you well know, have expressed sharp concern about the undervaluation of the Chinese currency and have repeatedly threatened to pass a bill that would impose a tariff on all Chinese goods imported into the United States, a measure that most economists believe would cause grave damage to both economies.

And trust is also eroded by economic policies in China that favor domestic over foreign business interests. Discriminatory trade and investment rules give rise to serious concerns among our business leaders, who traditionally have been the strongest supporters of a vibrant Sino-American economic relationship.

According to the 2011 survey by the Business Council of U.S. companies operating in China, serious concern continues to be expressed about their ability to receive required operating licenses and product approvals. Some companies report waiting months for such approvals, while watching their Chinese competitors gain them expeditiously in a matter of weeks, and nearly half of the businesses surveyed on this issue believe that protectionism is at least one reason for their difficulty.

U.S. business leaders have also expressed concern about subsidies, government contracts, and favorable financing given to Chinese companies by the central, provincial, and local governments.

The Chinese government is the largest shareholder in the country's 150 biggest companies, but U.S. businesses point out that favorable treatment is not limited to state-owned enterprises. The Chinese catalog, *Guiding Foreign Investment*, which was revised at the end of last year, continues to restrict opportunities for foreign investment. In fact, nearly 100 manufacturing and services sector have equity caps. Those equity caps prevent foreign firms from holding a controlling position in businesses that range from autos, biofuels, chemicals, express delivery, banking, security, clean energy, insurance, and so many more. And permission to open branches is often withheld or delayed, which restricts opportunities for foreign businesses to expand.

Third, there is the knowledge gap. One of the biggest impediments in recent years to building a strong Sino-American relationship is that Americans, including their elected representatives, know so little about China, its history, its culture, and what they have heard in recent months is mostly negative. They have no idea how China contributes to our economic growth. Many believe that we are losing good jobs here, because our companies have moved their production to China to export back to the United States when in fact about 90 percent of the companies in China are in China to sell to

One of the biggest impediments in recent years to building a strong Sino-American relationship is that Americans know so little about China ... and what they have heard in recent months is mostly negative. They have no idea how China contributes to our economic growth.

that huge and growing market, not to export back to the United States. And few know that while our trade deficit with China is large, the percentage of our trade deficit with Asia as a whole, including China, is roughly the same as it was a decade ago. The fact is we are buying much less from South Korea, Taiwan, Singapore, and more from facilities that those nations have invested in China.

And many see China as a rich adversary and do not know that China still has 150 million people still living in poverty with a per capita income based upon GDP that's about one-tenth of ours, nor are they aware of the daunting economic and political challenges that China faces as it moves away from its investment and export model of growth that I think Ken Lieberthal described so aptly this morning, for those that were here.

China must deal with a widening gap between its rural and urban citizens, make provision for a rapidly aging society, and deal with the chaotic environmental degradation of both land and water built up over three decades of overreliance on investment and heavy industry to generate its growth.

So what's the remedy? One way to counter the growing nationalism in both countries that is fueled by weak economic global conditions, the trust deficit, and the knowledge gap is to look for ways to engage China in shaping and implementing solutions to our economic differences. Rather than engaging in a zero-sum debate on trade and economic issues, we need to try to find win-win solutions for these issues. And better understanding of the respective challenges that each of us face will make it easier to construct such solutions. We have seen that in face-to-face meetings of our top leaders from both governments at our strategic economic dialogues, and our Joint Commission on Commerce and Trade and the 17 working groups that report to the commission can help.

For example, our concern that China's government procurement discriminates against the United States was raised with President Hu Jintao when he visited Washington in January of last year, and as a result, he agreed to delink China's indigenous innovation policies from government procurement. And following last November's Joint Commission on Commerce and Trade, the so-called "JCCT meetings," China's State Council issued a directive to provincial and local leaders to eliminate by December 1, 2011, all policies that link indigenous innovation and government procurement. In addition, provincial and local governments are now required to report their progress to the State Council, and as of February of this year, the U.S.-China Business Council reports that 13 provinces have released information about their efforts and the differences that they have made.

Rather than engaging in a zero-sum debate on trade and economic issues, we need to try to find win-win solutions ... Better understanding of the respective challenges that each of us face will make it easier to construct such solutions. We have seen that in face-to-face meetings of our top leaders from both governments at our strategic economic dialogues. The Joint Commission on Commerce and Trade can also help.

Also, at the Fourth Annual Strategic and Economic Dialogue, held just this past May, in response to our bilateral discussions, China agreed to raise the equity cap imposed upon foreign investors in securities joint ventures to 49 percent, not perfect but moving in the right direction. They agreed to reduce the waiting time for firms who can seek licenses to broaden their businesses, and they agreed to permit U.S. insurance companies to sell auto liability insurance.

Lack of transparency is another one of the top 10 major concerns of U.S. business. As a result of our bilateral negotiations that same November JCCT meeting, China agreed to implement a requirement that all proposed and economically related administrative regulations be posted on the State Council's website for public comment for not less than 30 days. While implementation has not been perfect, it is a whole lot better than it was before we had these bilateral discussions.

And, of course, we talk often about the failure to enforce intellectual property rights. Again, following the November JCCT meeting, China created a State Council group to monitor the enforcement and appointed Vice Premier Wang Qishan to lead the effort. The State Council issued a directive to provincial and local leaders to improve their intellectual property enforcement efforts, and a program was initiated to audit those efforts.

While we continue to get serious complaints with respect to China's enforcement of intellectual property rights, particularly its failure to impose criminal penalties, which is the international norm, a majority of our companies have reported that there has been a noticeable improvement, particularly in big cities like Beijing, Shanghai, and Guangzhou. In my view, we need to expand the number and frequency of our bilateral meetings and focus on opportunities for win-win outcomes on a various range of economic issues.

For example, both countries worry about equal treatment for their investors. China objects to the restrictions, perceived and real, in the United States that we place on its investments and cites the letter that 50 congressmen sent to Secretary Geithner expressing concern that China's fourth largest steel company, Anshan Iron and Steel, would be permitted to invest in a startup steel plant in Mississippi on the grounds that it would threaten U.S. security.

Both countries would benefit from the negotiation of a bilateral investment treaty that would provide assurance of national treatment to prospective investors, and provide a remedy where there was an alleged violation. Both [would also] benefit were China to join the Government Procurement Code.

Americans object to a long list of investment policies in China that discriminate against U.S. companies. Both would benefit from the negotiation of a bilateral investment treaty that would provide assurance of national treatment to prospective investors and provide a remedy where there was an alleged violation.

And businesses in both countries complain that restrictions that exist with respect to government procurement are offensive. The United States has various forms of Buy America embedded into a number of laws, and China's catalog guiding government purchases limit opportunities for foreigners. Both would benefit were China to join the Government Procurement Code.

China wants to attract high technology products and investment and to stimulate domestic development of such products. Increasingly, China investors are obtaining patents for their inventions. At the same time, Americans lose billions of dollars each year in China as a result of theft of their intellectual property. Were China to impose criminal penalties for such violations, which is the international norm, that would benefit both Chinese and American inventors and entrepreneurs.

We want greater transparency with respect to rules governing business activity. China wants to counter corruption that gives rise to social protests. Requiring all three levels of government in China to publish their rules governing businesses would provide greater regulatory clarity and help prevent the deviation that would benefit entrepreneurs both in China and in the United States.

And, currently, the United States is negotiating the Trans-Pacific Partnership to open markets among 11 nations of the Asia-Pacific Region. China, the largest economy in Asia, should not be excluded. Both sides would be benefitted by what we call "open architecture" of the sort used by the World Trade Organization, which welcomes additional governments willing to comply with the high-level commitments they negotiated or having been negotiated in an agreement. That format has been a success with the WTO Government Procurement Code, which now has 44 members.

And, of course, where negotiations fail to solve economic differences, we should use the World Trade Organization dispute settlement body to resolve the issue, a substantial benefit that resulting from China joining the WTO. In the intervening decade since it joined, both governments have brought and won cases. The WTO enables us to secure a neutral resolution of our differences, avoiding the build-up of animosity and the erosion of trust.

A strong and vibrant bilateral relationship is essential to our future economic growth, and our business community has a role to play. It can support the number and frequency of our leaders' dialogues, its efforts to find win-win solutions. It can support and push for a bilateral investment treaty and attempts to have China join the Government Procurement Code. And it can speak publicly, much more than it is doing today, to employees, suppliers, and government leaders about the importance of the bilateral relationship. Progress on economic and trade issues will help build the trust needed to strengthen the overall Sino-American relationship, which is critical to dealing effectively with the tough issues that both governments face and in so doing will enhance the prosperity and security for the citizens of both China and the United States and indeed for the citizens of the world.

A strong and vibrant bilateral relationship is essential to our future economic growth, and our business community has a role to play.

And I thank you.

[Applause.]

Takeaways – Mr. Nelson Dong

- People in all U.S. states and in various commercial sectors, including agriculture, benefit enormously from trade with China.
- In both countries, there is concern that the other country does not provide a “level playing field” for their businesses. Examples of restrictions include: the continued predominance of state-owned enterprises (SOEs) in China; Chinese regulations on foreign investment, ownership, and market access; and American restrictions on the export of dual-use technology.
- Personal relationships strengthen the business relationship and, in turn, the bilateral relationship.

NELSON DONG: Good afternoon. I was glad that you were served such large portions at lunch, so that you would have anesthesia before the pain begins here.

I want to thank David in particular for inviting me to take part in this conference, although when he showed me the program, I began to think of my grade school examinations in which you were given a row of objects, one of which didn't belong, and then I began to have second thoughts about coming to take part today. But I think David wanted me to present, to some extent, the micro view of the business community. Particularly, as you'll note from the program, I am the only speaker of Chinese descent in the program today, and I'm also the only speaker from outside the Beltway. So I'm going to be trying to carry a lot of baggage here today.

But I want to acknowledge that I have been learning a great deal in this program. Carla in particular has been an incredible teacher to me over the years, and I am very grateful to her, and to Doug [Paal] who is going to speak in a bit. So, if my comments today lack some precision, please blame the student and not my great teachers.

I want to begin by talking about some data points in the U.S.-China business relationship. China and the United States are certainly bonded in a way that's very unique in the world economy today. Our exports to China reached \$104 billion last year, which is a record. If you count the trade through Hong Kong, that rose to \$140 billion. It's now our third largest market in the world and also our single largest supplier of imports.

China and the United States are ... bonded in a way that's unique in the world economy today.

What is interesting, if you get below those macro numbers, is how well distributed across the United States this export economy has become. California is one. Washington State, my home state, is number two, and then it goes to Texas, Louisiana, New York, Illinois, Pennsylvania, Georgia, Oregon, and South Carolina, in that order. And that is an incredibly diverse number of states that represent really almost all segments of the U.S. economy.

When President Hu came during the Bush administration on a state visit, we made a great deal of his visit to the other Washington in Seattle, and at that time, we were very proud that President Hu acknowledged the incredible business community leadership in building the bonds between the United States and China, particularly acknowledging such incredible companies as Boeing, Microsoft, Amazon, and Starbucks, which are really exemplary corporate citizens in my community and who have a very, very strong presence in China. Indeed, Boeing this year marks its 40th anniversary doing business in China, and it's a cardinal event in the corporate history of that company.



NELSON DONG, Dorsey & Whitney LLP

The trajectory for U.S. export growth is quite strong. If you look back to the numbers going back to 2001, from 2001 to 2012 U.S. exports grew from a mere \$16 billion to \$104 billion, which is an increase of 542 percent. If you index that same period, that same decade, the ROW [Rest of World] minus China only grew 80 percent in that same time frame. So we can see the very, very dramatic difference.

If you slice the data again slightly differently, instead of going by state but instead by the industrial and commercial sectors of our U.S. economy, interestingly and often lost here in

Washington, our number-one export to China is crop production. The U.S. Commerce Department lists that right at the top, above computers and electronics, above chemicals and other things, even above Boeing airplanes, but And the question that was asked this morning, rhetorically, how will China feed 1-point-some-billion people, it's because it's able now to access food markets around the world, in Brazil and Argentina and in Canada and increasingly across the entire grain belt of the United States, both in the northern tier and the southern tier. We have farmers in small communities all across Iowa, North Dakota, South Dakota, Minnesota,

How will China feed 1.3 billion people? Because it's able now to access food markets around the world. We have farmers in small communities all across [the American Midwest] who wake up each morning and look at grain futures in China, because they know that their markets depend on access there.

Wisconsin, who wake up each morning and look at grain futures in China, because they know that their markets depend on access there. Apple growers in Washington State are deeply elated that the barriers are falling for apples in China. And so across many parts of our economy, not just in the industrial centers, but across the vast heartland of American farmers, we have a great deal to trade with China, and it goes down through many different segments.

Following up on Jim Fallows' comments this morning about the hope for greater understanding and bridging between our two economies, I thought I would improvise some comments here from some other talks that I usually give in other contexts.

China today sends more foreign graduate students to the United States than any other nation in the world. Currently, 22 percent of all foreign students studying in American colleges and universities are from China. That's about 158,000 in the current academic year. Increasingly, they are represented in all of our finest institutions of higher education and research. Indeed, in the decade between 2000 and 2009, China increased its number of Ph.D.'s earned in science, technology, engineering, and mathematics in the United States from 2,034 in the year 2000 to almost 4,000 in 2009. Fortunately, for the U.S. community and certainly for companies like Microsoft and Intel and others, a great number of those individuals are choosing to stay in the United States under H-1B visas and then eventually to get their green cards and to become American citizens.

This is a little-noted but I think very important phenomenon in terms of bridging the differences between China and the United States, because these ethnic Chinese are very comfortable, linguistically and culturally, in mediating the connections between China and the U.S. I can say quite honestly in my almost 30 years of doing counseling work with American businesses across the United States who are seeking access to China and China's markets and China's supply chains, most of them rely on these immigrants to do that and to be able to go back and forth every day.

In that regard, I'll tell a digression here involving my own family. I have two sons, Philip who is 26 and William who is 25. Phil spent 2-1/2 years working in China as a teacher and as an NGO in environmental affairs in Beijing. He was able to do that because American schools invested in him and trained him culturally and linguistically to be able to function in China.

My son just came home 2 nights ago from 2-1/2 weeks in Shanghai, because following receipt of his master's degree at Stanford this June, the next morning, proudly for his father, he went to work and finally got off the Bank of Dad and is now working for a young startup company that immediately upon forming in Silicon Valley knew that its supply chain would depend on China, knew that its relationships with producers in the Shanghai area and also in Dongguan. So, as a consequence, they immediately began recruiting young engineers to

China today sends more foreign graduate students to the United States than any other nation in the world. ... A great number of those individuals are choosing to stay This is a little-noted but very important phenomenon in terms of bridging the differences between China and the United States.

their startup company who had the ability to function both in English and in Chinese and who understood, obviously, the technology.

Now, much due to parental pressure, my son took a lot of Chinese in college, and even in graduate school, he took a special course at Stanford called Chinese for Engineers. And so he was just able to finish 2-1/2 weeks monolingually in China on the factory floor working with engineers, working with engineering managers and production designers there, and he reported to me on the phone the other night how critical it was to have that language skill, to be able to bridge between his company's management in Palo Alto and his suppliers and designers in China. It is just sort of beyond belief that we don't understand the human factor that's so essential in building these bonds between American businesses and ultimately then in strengthening the relationships between the two countries. So I want to give you that hopeful sign in regard to Jim's comments earlier, but now comes the downer.

The U.S.-China Business Council does a survey annually of CEOs and talks about their issues in China, and I will just read quickly the litany of the top 10 in the 2011 survey and then refer you to their website, so you can get this. At the top of their list was staffing and recruitment of local personnel. That's not really a government policy issue, but right below that, it goes to licensing and Chinese government approvals; rising operating costs; difficulties of competing with Chinese companies, especially SOEs that enjoy state subsidies and preferences; IP infringement, the whole battle of standards and conformity assessment, which is the new second war out there in the trenches of companies; restrictions on inbound FDI, including ownership limits for foreign investors; total lack of transparency in government regulation, echoing what Carla said a moment ago, and the lack of national treatment on par with local Chinese enterprises; and finally, key market access in sectors such as finance, the law, information technology, and the telecom sector.

So many of these factors are going to be directly tied to the policy of the incoming leadership team that the Chinese Communist Party will select soon, and I think it's very important for the business community to keep an eye on the leadership and to understand how much that will affect their businesses in China each and every day as they try to do business there. But make no mistake about it, American business is wholly dedicated to China today and very much focused on it and has its own plans and hopes for that future and believes in that market relationship with China all across America. So I bring that heartening news.

Many of the issues CEOs list as most important in China are going to be directly tied to the policy of the incoming leadership team. ... It's very important for the business community to keep an eye on the leadership and to understand how much that will affect their businesses in China.

At the same time, I think they are very daunted by the differences in the Chinese system of doing business, and probably most fundamental and central to that is the role of the state-owned enterprises, which are owned at municipal, provincial, and national levels. According to some statistics that have been published by China's National Bureau of Statistics, roughly one-third of all urban investment in China is in the hands of SOEs that

Without the reform of the SOE paradigm, there is a mutually reinforcing problem of a single party and the lack of transparency and accountability that allows the government to manipulate the economic system and make non-economic, non-rational, non-market decisions ... that then affect the investments and other efforts that foreign players are attempting to make in China.

are 100 percent owned by one level of government or another, and another 26 percent is owned by limited liability companies, which on the surface appear to be private companies but in fact are subsidiaries of other SOEs. So something on the order of 60 percent of the urban economy in China today is in one way or another affected by the SOE paradigm. And that, I think, is not only an issue for American companies trying to compete there effectively, but it is probably also one of the deep reform issues embedded in the comments that Ken and others made earlier today, because without reform of that, there is a mutually reinforcing problem of a single party and then the lack of transparency and lack of accountability that allows the government to manipulate the economic system and make non-economic, non-rational, non-market

decisions, often behind the scenes, that then affect the investments and other efforts that other foreign players are attempting to make in China.

One other factor I think is relevant to the technology sector in particular in the United States and its efforts to expand in China and to work with their colleagues and partners there, is that the United States maintains an arms embargo against China that dates back to Tiananmen. Maybe because I am what Jim referred to kindly as the "wrinkles of reality of China," I remember the brief period before 1989 when we did not have a full-fledged legal embargo on arms, and the United States simply took China on a case-by-case basis. But since 1989, we've had a statutory barrier buried in what's known to lawyers as the ITAR, which simply says that all of that technology is off limits to China, and we then, by congressional decision, added communication satellites to that pile of things, so that all comsats and all equipment tied to comsats are treated as if they were machine guns or flamethrowers. So vast parts of the U.S. economy are off limits to the Chinese, and as might be predictable, they make then illicit efforts to obtain access to that technology and are doing so all the time, as reflected in the DoD white paper that comes out each year.

We have had a vast decontrol of dual-use technologies being exportable to China, but we still have substantial quantities of that under control, under the jurisdiction of the Department of Commerce, and that is gradually working itself out. So notwithstanding loud protests about the huge areas of technology that are off limits, I think the U.S. business community is satisfied that apart from communications technology and the defense sector, most parts of advanced American technology can be put into play in the Chinese market and are being put into play.

The flip side of all of this discussion about exports and manufacturers going to China or buying goods there or selling goods there is the other end of the equation, which is the Chinese coming here. Carla made reference several times in her remarks, just before mine, about the Chinese perception that the playing field is not level for them. It is interesting

that on the August 27th issue of the *Washington Post*, there was a long article about the efforts of Huawei and ZTE to enhance its presence here in this city through paid lobbyists and government relations personnel who are trying to change the perception on the Hill and in the media about those companies and so forth. I wish them well. I hope that that campaign succeeds.

But beneath that high-profile lightning rod kind of deal, actually many Chinese companies are doing well in the United States and are investing and growing their businesses here. I don't think you can go into a Walmart or a Target in the United States today and not find Chinese-made goods, and increasingly Chinese-branded goods, such as Lenovo in North Carolina where the state is very proud that it has one of the largest investments from China in the entire country. And this is happening in countless communities across the Heartland, particularly in the automobile sector, where quietly, unobtrusively, Chinese parts suppliers have been buying up smaller businesses, particularly businesses that are generational change businesses in the Midwest that have built auto parts for GM, for Chrysler, for Ford, and they are doing that well. And they are integrating into those communities and learning. Just as Americans learn to do business in China, the Chinese are learning to do business here.

So I would say notwithstanding some of the larger cosmic and policy differences that separate, the business community on the whole across the country is optimistic about the future and feels strongly that it will succeed if political leadership in both countries keep their eye on the ball and keep going in the way that they should and in the ways that Carla and Ken and others outlined earlier today.

So, with that, those are my remarks from the other Washington, from a country lawyer. Thank you.

[Applause.]

Q&A for Session 3

ATTENDEE: One of the things that has not really been touched on but needs to be – and, Nelson, I know you have thoughts on this – is the broad challenge of an ungoverned and unmeasurable cyber future between the two countries. Richard Clarke is known for his flamboyant, high-publicity statements on the subject – and he said a year ago that some vast percentage of all American companies have been hacked by China, et cetera. It's a dangerous field because it is so untraceable and so unmeasurable, but it is something we are all living with. Certainly, the intelligence and the defense communities are. The Chinese are certainly aware that they are being tested and hacked by other countries. They expect the United States is one of those as well. Could either of you comment on this, this kind of a vaporous element in the U.S.-China relationship, now particularly vis-à-vis business?

AMBASSADOR CARLA A. HILLS: Bob, I think one of the great dangers that we have looking forward is cybersecurity. I think that is the thrust of your remarks, and it is a danger with respect to other states and non-state actors. We are going to have to build firewalls, collaboration, and use all means that we can to try to deal with it.

You talk to our defense industry. I see some uniforms in the room. And I would say that that is a big concern for our defense industry, and just think about when you used to live here in Washington D.C. The power goes out 5, 6, 7 days. People lose all the food in their refrigerators. They can't use their computers. Their phones turn off. You could shut down the electric grid across the country, which is relatively old. Computers are a part of its operation. So this is a big, big challenge as we look forward.

And I don't think you can limit the risk to the Chinese. I am told by those that look at the systems, a lot of it is funneled through the Chinese, but it could be from India or Russia. It could be Afghanistan. It could be a number of other places and a big challenge for us – and others, I might add.

NELSON DONG: I'll leave it at that.

ATTENDEE: Thank you very much. I had a question about – you mentioned advanced technology, dual-use technology and so forth. The issue of fidelity of venues when there is a history of diversion and unauthorized venues and China's stated policy of civil-military integration to leverage both, what would you suggest as a policy recommendation to mitigate such risks?

NELSON DONG: The reference was to a stated national policy in China, that they will adapt anything that is usable in the civilian sector to benefit the PLA and the industrial infrastructure supporting the defense structure in China.

I think when the regulations were being prepared, everyone in the government was aware that allowing more technology to flow to China potentially included that, and I think where there are known diversions that have occurred, they have been stopped. I think most American companies are extremely conscientious about that.

I have one client that I was just working with. It's just one case, I don't mean to suggest it's statistically significant, but they had an opportunity to sell a quarter-million-dollar device to a large jet engine developer in China that does jet engines for commercial aircraft but also for the military aircraft in the PLA. And they knew that. They had done their homework. They had done their own research. They have a product that is totally salable in China, but the CEO in this case, because of that policy that you have referred to, asked his director of sales at the cost of that gentleman's bonus not to make the sale, because they felt it was just too touchy and too sensitive in that environment.

So I think companies that have that kind of technology are self-policing and are aware of it and try to be vigilant about that kind of diversion, and I know from talking with my colleagues at the Office of Export Enforcement and the Department of Homeland Security that American companies spot these kinds of things and report them and are working with the government to work on that.

ATTENDEE: Thank you both again. Governor Romney has stated that once he assumes office, he will label China as a "currency manipulator." Can you both comment on the consequences of that happening, and also, your personal opinion, do you think China should be labeled like that? Thank you.

AMBASSADOR CARLA A. HILLS: I have certainly heard Governor Romney say "on his first day of office," and I would warn him, he's going to be awfully busy on his first day.

[Laughter.]

AMBASSADOR CARLA A. HILLS: But if he can – it would be a very bad move, in my opinion. The U.S. Congress has been agitating for several years about a bill that would



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AMBASSADOR CARLA A. HILLS, Hills & Company
MR. NELSON DONG, Dorsey & Whitney LLP

enable the President under appropriate circumstances to cite a currency manipulator and naming China as one and pushing our Secretary of Treasury to name the Chinese in that regard.

If you look at the appreciation of the currency, it has tended to go up. It is tough for us to complain about manipulation when we have had easing on two major efforts, which, of course, affects our currency. What we need to do is sit down in the Group of 20 and precede that meeting with a bilateral to talk about this global issue of how we deal with the imbalance, because that is why we are concerned about our currency.

In my view, were we to name China as a currency manipulator and apply a tariff to everything that comes in from China, we would very much hurt our economy. Put aside that I think in a nanosecond, China would have retribution; put that aside. But the fact is who buys the cheap goods that comes in from China: our unemployed, our poor who have to get the cheap tennis shoes and sweaters from some lower cost outlet. And so we would be hurting our own population, while we would not be advancing our interests.

And then you take the upper end of it, like Apple – I see a lot of equipment around the room – which has some of it snapped together using a chip from China, a wire from South Korea, but it's assembled in China, and you've seen the data that show that China's value-added is about \$4 out of the \$150. So who would we hurt? We would hurt good old American Apple, and this doesn't make much sense. So, as an economic proposition, economists are saying don't do it.

As a bilateral diplomatic proposition, we would trigger a trade war that would absolutely spread like wildfire, because if we did it, you would, tit for tat, move up the realm. So it would be a bad policy, and I have to believe that if Governor Romney assumes office, he would find a way to not fulfill that commitment.

NELSON DONG: My only addition to that is to recall Jim's comments at lunchtime about the 98 versus 2 percent situations in China. I think if Governor Romney were to make such a pronouncement on the first day in office, it would produce one of those 2 percent cases of ultra-nationalism in China that we would all live to regret.

ATTENDEE: Recently, there was an op-ed coming out of CSIS that talked about how China has been using economics as a coercive diplomacy tool, especially in dealing with their neighbors in territorial disputes. Do you see this as an ongoing trend or something that we think they'll use increasingly in the future, especially as they rise?

AMBASSADOR CARLA A. HILLS: I'm not sure I got the full content of your question. Is China using soft power?

ATTENDEE: Using economic policy. For example, when the Japanese detained their fishermen, the captain of the fishing boat, and they stopped exports of rare earth minerals and they stopped imports of banana from the Philippines during the Scarborough Shoal.

AMBASSADOR CARLA A. HILLS: Well, I'm not sure what your question is, but we all react to our national interest. I think that China has reacted rather brusquely to the collisions in the South China Sea, it would be far better off to negotiate, as Secretary Clinton has suggested, a code for the operations in the South China Sea.

And one could imagine, for example, that you could negotiate a division of the resources that you believe that are under a shoal or a rock, so that one side gets 30 percent and the other side gets 40 percent, and the next shoal or rock, you negotiate it.

We are not in the best position to lead on this. I think we can say, as we have said, and I support the U.S. Government's position that we want to keep the corridors of navigation open, and we don't want turmoil, but that we are not getting involved on one side or the other. And I think it's incumbent upon China to figure out a way, not that they're a big country and they are going to deal bilaterally with those claimants, but to have a code of conduct and deal more multilaterally with this issue of resources, because it's going to come up also in the Arctic where we all have claims on minerals as the melting of the ice creates the corridor toward the north.

And my only disappointment with my own government is we should have confirmed the Law of the Sea. It was negotiated in 1982, and it is a shame that we are not fully observing those rules and regulations. It would give us a better voice as we talk about these kinds of problems.

NELSON DONG: My response to your question would be that I would be loath to criticize the Chinese government for doing what it did in that instance, and that is using economic power, if that's what you mean.

When we have on the books the International Economic Emergency Powers Act, which gives the power to the President to alter all manners of economic relationships and to stop the flow of goods to people, to countries, to organizations – and President Obama, President Bush, every administration since that law was adopted in 1970s – we have altered the course of economic affairs for political ends in this country many, many times. The best-known case, obviously, is the Cuban embargo, but we have embargos on Iran. We have embargos on Syria. We use the economic tool in lieu of more confrontational military intervention in the hopes that we will induce behavior politically in other countries. I find it hard to fault the Chinese for adopting a tool that we virtually invented.

ATTENDEE: Scott Tong, Marketplace Public Radio.

I was looking at Nelson's list of the U.S. companies' headaches in China, and I want to ask you about that. I moved out to China 6 years ago, and the list is kind of the same, maybe with the exception of rising operating cost, which has really accelerated up the list as far as I can tell. And a lot of these issues, we're talking about here in Washington but are outside the purview of a lot of these policy questions. I wonder if you look forward 5, 10 years, how might this list change, if it does.

And the other question I had for you is on energy. If this shale technology is one of the underlying economic stories in North America, China has these geological formations as well. As far as access for American companies, green energy has been a big headache. Do you see brown energy following the same trajectory?

NELSON DONG: Let me try to give you a limited answer to the last question to the limits of my knowledge. I think China at the moment has enough energy needs and enough money to pay for multiple pathways to solutions to their energy future, that they're probably betting on everything.

If you look, for instance, at their nuclear industry right now, they have bought two or three or four of almost every type of nuclear reactor the world has to sell, and they are all putting them out there as experiments, the way we used to talk about the 50 states being different experimental models for federalism. And they are all seeing whether they are going to work. They are endorsing clean energy when they can. They are looking at coal gasification. They are looking at all the technologies. I don't think there is a single technology that they are not looking at as a part of their overall energy solution efforts.

On the first question, I don't have much of a crystal ball on that, but right now I think the drivers in terms of shortage of personnel at management levels are qualified to take over their operations and grow them will I think remain a gating factor for many American companies. I think IPR issues will remain pretty constant. One can only hope for increasing degrees of transparency. I think the Chinese legal system is certainly more transparent today than it was a decade ago, and it's just slow. It's very, very slow to make progress in these things.

I think one heartening sign is that although American companies used to regularly encounter blatant corruption and efforts to shake them down, by and large, American businesses are able to do that without that kind of activity being directed toward them today, and I think that's much to the good. I think the efforts to support anticorruption in China are beginning to take root.

AMBASSADOR CARLA A. HILLS: Let me just say that on the energy theater, that is one of the big sectors that China is investing in the United States. It is particularly in wind and the like.

China has about \$6 billion of investment in the United States today. We have \$66 billion of investment in China, and I think over the years, if you look over a decade-long horizon, China in its going-out policy will continue to invest, will continue to be sensitive toward those things that can be close to the defense industry and, hence, the worry about Huawei and telecommunications, but you go to the governors and the mayors who want tax revenues and want jobs, and they will embrace Chinese. And over the years, as China comes here and becomes

Over the years, as China comes here and becomes acquainted with American ways and provides jobs, and those employees become acquainted and indebted to the Chinese investors, you will find the possibility of harmony in the relationship.

acquainted with American ways and provides jobs, so those employees become acquainted and indebted to the Chinese investors, you will find the possibility of harmony in the relationship.

The list of 10 that the U.S.-China Business Council, when it does its yearly surveys – and it's done these surveys since 1996 – has changed. Cost of labor and getting trained personnel has jumped to the top. It was invisible in 1996. Actually, there has been an improvement in enforcement of intellectual property. Some of them have dropped down on their list. I think intellectual property went from 5 to 6, still a big concern.

So I see the path, if we all act sensibly, as being positive. Keep in mind, in 1990 we were very exercised about the Japanese and the competition between our two societies, and I can remember a congressman saying to me, "Mrs. Hills, the Japanese are going to be making the computer chips, and all we will have are potato chips."

[Laughter.]

AMBASSADOR CARLA A. HILLS: That's changed. With Toyota investing in Ohio, Tennessee, and California, I'll tell you those governors love Toyota, and the same thing will occur when China invests in the Heartland of the country, provides jobs and tax revenues, and raises knowledge by Americans to China and the potential.

DR. JEFFREY BECKER: I think it's increasingly clear as we've moved throughout this day how important the U.S.-China economic relationship is on a number of different levels, not only for the economic level domestically for both countries, but for foreign policy issues as well, not just the U.S. business community.

So please join me in thanking our panelists for their insightful comments.

[Applause.]

Session 4: What's at stake for the region?

Panel introduction: Dr. Thomas Bickford, CNA China Studies

DR. THOMAS BICKFORD: Welcome to the last but by no means least panel of the day. This panel is going to turn away from U.S. and China to China and the rest of the region. The new leadership is coming in at a particularly interesting time, not just because of rising tensions over disputes in East China Sea and South China Sea, but also because of increasingly complex and dynamic economic and political relations between China, countries of Southeast Asia and Northeast Asia.

We have two excellent panelists to discuss these issues. First, we will have Ambassador Ashok Mirpuri, who has just become Singapore's Ambassador here to the U.S., arriving in July. Prior to that, he was Ambassador in Jakarta, and before that, High Commissioner in Malaysia and Australia. He has a wide and deep knowledge of issues in Southeast Asia, and we look forward to hearing our first non-American point of view.

And I understand this is your first public speech in your new role. So, on behalf of CNA, thank you very deeply for agreeing to be with us. Thank you so much.

[Applause.]

DR. THOMAS BICKFORD: As our commentator, we have Dr. Douglas Paal, who is currently the Vice President for Studies at the Carnegie Endowment for International Peace, and he also brings a wide and deep knowledge of the region, having served on the National Security Council for two presidents, served at the State Department and at our embassies in Singapore and Beijing, and directed the America Institute in Taiwan from 2002 to 2006.

And with that, I will turn it over to you. Ambassador, the floor is yours.

Speaker: Ambassador Ashok Mirpuri, Embassy of the Republic of Singapore

Takeaways – Ambassador Ashok Mirpuri

- The nations of Southeast Asia occupy a strategically critical location. As such, they have taken on increased importance for both the U.S. and China.
- ASEAN nations share the U.S. and China's desire for a stable and prosperous Asia-Pacific.
- ASEAN's strength lies in its unity and its autonomy. A divided ASEAN does not help the interests of either the U.S. or China.
- China's considerable economic and military expansion has caused its actions to come under increased regional scrutiny in recent years.
- ASEAN nations fear a deteriorated U.S.-China relationship. They do not wish their region to become a proxy for major power rivalry.

AMBASSADOR ASHOK MIRPURI: Thank you, Tom, for that introduction.

When I was invited to speak over here, it was one of the first things when I arrived. My staff came to me and said, "There is a speech on the transition in China, and they want to know regional views," and I said, "Maybe we will wait until I settle in a bit more." And they insisted that it was a worthwhile effort to come here and speak to CNA. Looking at all of you after a full day here, you really are the hardcore China people –

[Laughter.]

AMBASSADOR ASHOK MIRPURI: – because you've stayed a whole day. You stayed through lunch and are staying to hear the regional views.

When Tom made the introduction just now, he said that I am the first non-American speaker here really looking at China from the region. The whole U.S.-China relationship is so important to the region. So it is really a triangular relationship that has a major focus for all of us in Southeast Asia.

You have been here the whole day, and you have looked at the outlook for China with the transition coming up. You have looked ahead a few years. Like previous speakers, I don't have a crystal ball to gaze into the future. I cannot anticipate the possible outcomes of a successful or an unsuccessful China. Most of the conversations are about a successful China, but I think that we should also start thinking, particularly from the region, if there are certain issues that delay throughout the transition. I think that we should be looking forward, in the future, at how do we handle an unsuccessful China or a successful China in the regional context.

What I want to offer to you is a view from Southeast Asia, from ASEAN, on what we see as a possible trajectory of ASEAN-China relations, as well as some of the emerging issues. As was mentioned, I just moved to Washington, D.C., from the region. I am part of the Southeast Asian rebalance into the U.S.

[Laughter.]

AMBASSADOR ASHOK MIRPURI: I have never served in the U.S., so I get a different perspective. I hope that I can put forward some of the perspectives from the region in our discussion.

You are all aware of ASEAN. We have some Navy officers here. You know that ASEAN straddles two significant sea lanes of communication: the Malacca Straits and the South China Sea. These two sea lanes are the lifelines of the Asia Pacific and the Indian Ocean and give Southeast Asia and ASEAN strategic significance that extends beyond the geography of the region. The only reason we speak about Southeast Asia is because of the strategic significance of these sea lanes that we have. What is also starting now to contribute to ASEAN strategic significance is the growing economic potential of Southeast Asia as well as the resources and the commodities that are transshipped and exported from Southeast Asia to the rest of the world.

I am using the term "Asia Pacific," which I think we all expect to be the main arena of China's rise in the immediate future, but it is far more complex than just Southeast Asia. There is a Northeast Asia region as well, which includes key countries like Japan, ROK, DPRK, and that is a very historically challenging region. I am going to sensibly stay away from that this afternoon. We can take it up in some of the discussion, but they have their own set of dynamics in their relationships with China and especially among themselves.



AMBASSADOR ASHOK MIRPURI
Ambassador of the Republic of Singapore to the
United States

For China, I think what you will have to anticipate, that as the interests grow, their interests are going to expand beyond Asia Pacific into other parts of the world. The Chinese have to consider events in the Middle East and Africa. Like the U.S. does as a global power, you look at events around the world, I think the Chinese will have to look in that context as well. But what I think today will be useful to do is really to look at Southeast Asia in terms of the immediate relationship with China.

ASEAN has become, partly by accident, partly by design, the center of all the ongoing discussions on the regional security and economic architecture. This architecture in the Asia Pacific includes all the major powers – China, the U.S., India, Japan, Australia, and other countries. This idea of ASEAN centrality is not meant as an immodest claim about the size and influence of the 10 Southeast Asian countries who are members of ASEAN, but rather it's a recognition of the reality of the relationships in the Asia Pacific.

ASEAN is a good platform, because we are a nonthreatening, friendly group of countries for the major powers to engage Southeast Asia as well as for the major powers to engage among themselves. By providing that space where Japanese and Chinese leaders can meet, where U.S. and Chinese presidents can meet, that's really one key role that ASEAN plays. You can turn up there without too much of the publicity of a major visit to either country.

ASEAN does not have any ability to impose outcomes on the major powers. It is only by speaking, by putting a spotlight on some actions that we can put some moral pressure on our neighbors, but there is also a certain credibility that we bring, because we speak with one voice on so many issues.

What is important is that ASEAN has developed, as I mentioned, a little bit by accident. It is coming together, more or less, by these common concerns, and these concerns are not just regional security concerns. They are concerns about economic and functional cooperation. They are concerns about dealing with regional disasters, dealing with crisis, and although we have 10 countries of varying sizes, disparate systems, dissimilar economic models, what binds us together are shared concerns about the future.

Another unique feature, which is very important to understand, particularly important as we discuss the South China Sea issue, is the ASEAN function of consensus. ASEAN decision-making is purely by consensus. On the positive side, it means that a larger member cannot impose its will on a smaller member, and that's good for a country like Singapore, that no one can. But on the other hand, decision-making is slow and sometimes frustrating for our external partners who cannot understand why is this consensus, why can't you reach an agreement. But that's the way ASEAN been shaped. When we try and put elements into the ASEAN idea, it is important to understand consensus making.

The central interest of ASEAN matches that of the U.S. and China, which is a stable and prosperous Asia Pacific.

ASEAN has become, partly by accident, partly by design, the center of all the ongoing discussions on the regional security and economic architecture. ... ASEAN does not have any ability to impose outcomes on the major powers. It is only ... by putting a spotlight on some actions that we can put some moral pressure on our neighbors, and there is a certain credibility that we bring, because we speak with one voice on many issues.

Overall, the central interest of ASEAN matches those of the U.S. and China, which is a stable and prosperous Asia Pacific. ASEAN was, in fact, founded during the

cold war as an organization to stabilize relationships among the countries of the region. We have sought to build a region that is autonomous, that is stable, which has got all the necessary elements for economic development. The alternative is a divided Southeast Asia, which I think nobody wants to see. Neither the U.S. nor China wants to see a divided Southeast Asia which is a proxy arena for the major powers.

One way of moving towards this – and we spoke about the economic relationships earlier between the U.S. and China – is what we are doing in Southeast Asia, which is building up a network of regional cooperation, particularly economic cooperation. There is a whole noodle soup of Free Trade Agreements, the Trans-Pacific Partnership as well, and a recently launched ASEAN Framework for Regional Comprehensive Economic Partnership. The U.S. is part of the TPP, not some of the other arrangements that we have. There are economic groupings, such as APEC, and then there are security fora, such as the ARF; the ASEAN Regional Forum; the ASEAN Plus Three, which includes China, Japan, Korea; the East Asia Summit, which the U.S. and Russia joined for the first time last year; and the ASEAN Defense Ministers Plus, which is ASEAN and eight other countries at a defense minister level. Those are some of the areas that people are looking at in terms of the security of the region.

Again, as I mentioned, the external countries really are comfortable seeing ASEAN in the driving seat of all these things, because we are a nonthreatening power, but it's not an automatic state of affairs for ASEAN. We have to earn it. We have to maintain it, and it's something that ASEAN countries are very aware of. Just saying that you are the center of the regional relationship doesn't make you the center. You have to work hard for that. You have to maintain that.

Each ASEAN country has to balance national interest with regional interest. ... This is critical to how ASEAN is going to deal with China and how China deals with us, as well as the way the U.S. looks at relationships within ASEAN.

And each ASEAN country has to balance national interest with regional interest. The Philippines, Vietnam, Malaysia, Brunei are claimant states in the South China Sea. They have national interests. The other six are non-claimant states. We have our national interest as well. But it is really that key of balancing national and regional interests which is critical to how ASEAN is going to organize itself and how ASEAN is going to deal with China and how China deals with us, as well as the way the U.S. looks at the relationships within ASEAN.

Now, I want to do a quick summary of China's engagement of ASEAN, because you heard just now about U.S.-China business engagement. I want to speak a little bit on China-ASEAN engagement.

China came late to the game to ASEAN. China only established diplomatic relations with all the Southeast Asian countries in the 1990s. I think Singapore was the last, after Indonesia. They only took on a dialogue partner relationship in 1996, but they have moved very aggressively since then to engage the region in economic terms.

In 2000, Premier Zhu Rongji offered ASEAN a Free Trade Agreement. That was subsequently signed in November 2002, the Framework Agreement shortly after the 16th Party Congress 10 years ago. That agreement, the ASEAN-China FTA, came into force in 2010. Since then, China's economic relationship with ASEAN has grown exponentially. China is now ASEAN's largest trading partner, and for China, ASEAN is its third largest trading partner. China is not the only dialogue partner with an FTA with ASEAN. Australia, Japan, Korea, New Zealand, and India already have FTAs. There is no FTA between ASEAN and the U.S., just as there is no FTA between China and the U.S.

The ASEAN-China FTA came into force in 2010. Since then, China's economic relationship with ASEAN has grown exponentially. ... There is no FTA between ASEAN and the U.S., or between China and the U.S.

Politically, up until recently, China supported the centrality of ASEAN to drive regional engagement. ASEAN was seen as an organization for China to manage perceptions about its rise, that it's seen as a friendly power. In 2002, China signed a Declaration on Conduct in the South China Sea. This was in line with its own interest to have a stable relationship with the region, and it's one of the strongest supports of ASEAN's community-building efforts.

What's happened in the last 10 years ... has been a rise in China's political and military weight, and that has somewhat changed the regional dynamics. Given its greater strategic heft, China's actions are starting to have a great impact on countries in Southeast Asia, and as a result, China's actions come under greater scrutiny.

What's happened in the last 10 years since the 16th Party Congress has been a rise in China's political and military weight, and that somewhat changed the regional dynamics. Given its greater strategic heft, China's actions are starting to have a greater impact on countries in Southeast Asia, and as a result, China's actions come under greater scrutiny, because we suddenly have another major power to deal with in the region. So it's not surprising that many Southeast Asian countries look at China's actions partly through the lens of their own historical relationships with China, which go back a long time, whether these are good or bad. So the region is adapting to China's new strategic weight, as is China adapting to the region with its new strategic weight. And the most obvious place where these tensions are starting

to emerge has been in the South China Sea, where there are competing claims among China and four ASEAN states. Singapore has no claims in the South China Sea. Like the U.S., our interest is in freedom of navigation and the peaceful resolution of disputes.

But there's been a flurry of activity in the South China Sea over the past few months. What had become very public was a lack of consensus to reflect developments in the South China Sea, and that highlighted the fact that you couldn't come to agreement about four paragraphs in a 160-paragraph document. But that became the focal point of all the discussions.

Now, in this failure to come up with a joint communiqué, ASEAN did not turn out looking good, but I must say that China, the U.S., the other parties do not look good, either. Everyone sort of came away and started to rethink how we managed that meeting and how we managed the issues around that meeting. I will consider some of these further in my remarks.

Putting aside the South China Sea for a moment, the ASEAN-China relationship is very, very broad. As I said, they have been a dialogue partner since 1996. They have regular ASEAN-China summits. They have given a \$10-billion China-ASEAN Fund and Investment Corporation. There is a program called Double 100,000 Goal of Student Mobility, to have students coming and going between ASEAN countries by 2020, and China is very ambitious in its engagement of ASEAN.

But the South China Sea issue will remain a constant source of tension between China and ASEAN if it is not properly handled. What's at stake is not just the territorial dispute at hand, but the way the region and the world perceives the manner in which China interacts with ASEAN. That's really the test case of how people view it.

So, as we come into that political transition in China, this is the context of China-ASEAN relations that the next generation of party leaders is going to inherit. It is a generally cooperative relationship, but with considerable uncertainty over how China will engage the region in the future. We expect China to have policy stability, both overall and domestic, in foreign policy, and any changes will be matters of small degrees.

On the foreign policy front, of course, it is too early to judge what the new administration will bring, but the incoming leadership have been members of the Politburo Standing Committee. They are part of the collective leadership. They know the issues that are there.

The primary concerns in China will really be domestic ones, and China's leadership faces many challenges: unbalanced regional development, the growing wealth gap, housing reform which need urging solutions. These are really the critical things for them.

With this domestic focus, we expect that a new leadership would want to see tranquility in the region. Regional peace is in their interest; it's in ASEAN's interest. And I think that they will try to continue to work with us on the South China Sea issues.

But there are some in ASEAN who are concerned about being affected by China's domestic political calculations. I missed the lunchtime talk, but I suspect this is the 2 percent that came up just now in the discussion. There is a narrative that China's leaders have to shore up their domestic standing by supporting domestic concerns and nationalistic sentiments on Chinese sovereignty and territorial disputes. New

There is a narrative that China's leaders have to shore up their domestic standing by supporting domestic concerns and nationalistic sentiments on Chinese sovereignty and territorial disputes. New leaders are unlikely to be able to come across as soft on any issues of critical national interest.

leaders are unlikely to be able to come across as soft on any issues of critical national interest. This is a common approach, as new leaders have to do. Sovereignty claims are always very, very emotive, and it is difficult to roll back once you let disputes become embroiled in domestic politics.

The bottom line is that nobody wants conflict in the South China Sea. Neither does anyone want ASEAN to be pitted against China. All countries in the region are trading nations that rely on the freedom of navigation. Unfortunately, ambiguity in territorial disputes can lead to problems, [and] there are some inherited positions that the new Chinese leadership will take on that will be very difficult to undo.

That's why ASEAN and China are trying to come together to work out a regional code of conduct in the South China Sea that will reduce tensions. I think the bottom line is nobody wants any conflict in the South China Sea. Neither does anyone want ASEAN to be pitted against China. All countries in the region are trading nations that rely on the freedom of navigation.

Unfortunately, ambiguity in territorial disputes can often lead to problems. So Singapore's position is that claimant states should settle their claims peacefully under the framework of international law, including the UN Convention of the Law of the Sea.

There are some inherited positions that a new leadership will take on. They will be very difficult to undo. For example, it is going to be very hard to ask the Chinese to withdraw the establishment of Sansha City, which they announced recently, or its opening of new oil blocks for gas exploration, oil and gas exploration. Similarly, Vietnam is not going to repeal its maritime law, nor would Philippines give up its claim to Scarborough Shoal. So these are the realities we have to deal with.

Our hope is that involved parties would think twice before taking actions that cannot be rolled back, and we hope that we are able to work cooperatively in moving towards this code of conduct.

We were very close to starting discussions on the code of conduct at the July meeting of ASEAN, and unfortunately, ASEAN was very surprised when during the meeting with China, they said the time was not right to begin discussions on the code of conduct. They had earlier said they were ready to commence discussions. I think they changed in the situation, and they said now they have to wait for the conditions to be right before they can move ahead, which means that there is going to be a delay. As Ambassador Hills said just now, we hope that they start discussing the code of conduct very soon, because that will help to broaden the narrative on the issues. It's no longer just a spotlight on what can be done, but really looking ahead at what can be done, not that it is going to solve the problems overnight. It will be a long negotiation process, but at least there's a process where we can talk about some of these issues.

What is not in China's interest for the new leadership is a divided ASEAN. I spoke of ASEAN's centrality, and ASEAN is only useful as a group together. So from Southeast Asia,

we hope that China understands that there is really no value in trying to split ASEAN up and essentially not even go in that direction. Similarly, I think other major powers, the U.S. included, should also be looking at ASEAN as a unified corps that they can work with, rather than one that splits up, trying to choose one or the other.

So the leadership, the region in Southeast Asia is really watching this transition in China, not just in terms of the ASEAN relationship, but also how it impacts U.S.-China relations, which has been the topic of discussion all day. While we are observers, we do have a vested interest in a stable and good U.S.-China relationship, which is not only the most important bilateral relationship for U.S. and China, but also for the whole world. My foreign minister, K. Shanmugam was here earlier this year, and when he gave a speech in Washington, D.C., he said ASEAN countries do not want to choose between China and the U.S. This point was reiterated by my prime minister, Lee Hsien Loong, last week in Beijing when he spoke to a Central Party school. We don't want to really make that choice.

[Southeast Asians] have a vested interest in a stable and good U.S.-China relationship, which is not only the most important bilateral relationship for U.S. and China, but also for the whole world.

We don't want to be a pawn or a proxy of a big power rivalry. That's where ASEAN sees status of working in the region, and we fear the consequences of negative U.S.-China relations, because it will affect the whole world and acutely impact Southeast Asia.

We are encouraged by the maturity of U.S.-China relations, even in this difficult year, you have had a number of issues that had sensitive issues, the Wang Lijun issue, the Chen Guangcheng issue. These were all very carefully handled, and I think that credit must go to both sides the way they managed these things.

But also what the region expects is that there are going to be new teams in place. There will be a new team in place in Beijing, and there will be a new team in place in Washington. And the region will be watching quite carefully, and there will be a period of readjustment and rebuilding of personal relationships and political understanding.

Let me say a few words about the U.S. role in the region. Singapore has long believed in the U.S. continued presence in Asia, and we believe that this has contributed to the region's prosperity and security. One strength of the U.S.-Asia Pacific strategy over the past 30 years has been it is essentially bipartisan. We don't see much difference between Democrat or Republican administrations, and it remains steady and consistent.

In the past 4 years, under the current administration, we've seen fairly significant progress. The rebalancing into Asia has come into place. There's the TPP negotiations. We have started an ASEAN-U.S. leaders meeting at an annual level, which the President first held, President Obama first held in Singapore in 2009, and we had the third consecutive meeting last year. The U.S. has appointed ambassadors to ASEAN, and more recently, at the ASEAN ministerial meetings, Secretary Clinton announced a \$50-million commitment to initiatives

in the Lower Mekong region. She has also led a large business contingent to participate in the U.S.-organized Commitment to Connectivity Forum in Siem Reap.

So Singapore and the other ASEAN countries appreciate these efforts of the U.S. Indeed, Secretary Clinton has sent strong signals when she broke tradition by visiting Indonesia first when she took office and the ASEAN Secretariat. She just made another swing to the region last week and visited Indonesia, China, Timor-Leste, Brunei, and she's now visited, I understand, every Asian country except for the DPRK.

While it is simplistic to measure engagement by adding to the number of high-level visits, the reality is that it remains a relevant barometer. In Asia, the warm handshake is very important, and getting out there is very, very critical. So President Obama's attendance at EAS, Secretary Clinton's frequent visits to the region, these show that Asia is a strategic priority for the U.S. The question is what comes next.

For the region, as we watch China's political change, we also watch whether the U.S. will sustain its relationship with Asia beyond the current administration. We are very keen for a very broad-based and multifaceted engagement, not just on the security side, but also but economic engagement, functional engagement, dealing with issues like humanitarian assistance and disaster relief, dealing through public-private partnerships, because those are opportunities for U.S. businesses to come into what is happening in Southeast Asia.

In Asia, the warm handshake is very important, and getting out there is critical. President Obama's attendance at EAS, Secretary Clinton's frequent visits to the region, these show that Asia is a strategic priorities for the U.S. ... As we watch China's political change, we will also watch whether the U.S. will sustain its relationship with Asia beyond the current administration. ... We want ... to be assured that the U.S. will sustain power in the Asia Pacific, and ASEAN must feel confident that the U.S. is there to stay.

Singapore has established our own structures to work with the U.S. We signed earlier this year what we call a "Third Country Training Technical Partnership," which allows people to be trained in either country from the region, and this serves to work on the strengths of each country to close development gaps in the region.

What we want is to be assured that the U.S. will sustain power in the Asia Pacific, and ASEAN must feel confident that the U.S. is there to stay. We hope that the budget cuts that the Pentagon is going to face will not affect U.S. plans for the realignment of U.S. forces in the Asia Pacific. Realistically, we don't expect the U.S. to necessarily defend ASEAN's interest, but we know the U.S. will defend its own interest, and U.S. interests are in the Asia Pacific. And that's a point that the region feels quite strongly, and that's why having U.S. firms come out is another critical part of how we see things being developed.

The best that the U.S. could do for U.S.-China and for U.S.-China-ASEAN relations is not only continuing its broad-based engagement, but also focus on developing broader topics. It's also important from the region's perspective that you manage some of the economic issues

over here, because there are some analysts in the region, in China, who feel that the U.S. is in decline, and I think that they would be making a mistake. One thing that my prime minister said last week in Beijing was that the U.S. will remain a dominant super power for the foreseeable future. Now, while you're facing certain problems, you are not a nation in decline, and I think that you need to send this message out. I have been here for 6 weeks, and I have just seen the political discussions over here. You need to send the message out that the economy will recover and come back after this.

In conclusion, I want to just say that ASEAN is a partner to the U.S. and China in the Asia Pacific, and we welcome the continued engagement of both powers in the region. What's at stake with the current leadership transition in China and the U.S. is the stability and prosperity of Asia and ASEAN. There is no point about talking about the future of ASEAN if ASEAN is divided. So, in that context, I think we are at a particular inflection point, and there is some uncertainty that the region looks at, but we hope that our partners will work together to build a positive path. Thank you.

[Applause.]

Takeaways – Dr. Douglas Paal

- Three positive trends favor the U.S. in Southeast Asia: (1) The U.S. is becoming more engaged in the region; (2) the U.S.-China economic imbalance is reversing; and (3) regional architecture is strengthening.
- However, upcoming elections and leadership transitions in the U.S., China, and the Asia-Pacific region present opportunities for policy mistakes. There is also a chance that China's new leadership will transfer its domestic troubles abroad.
- Policy makers in the U.S. must resist the temptation of going either too fast or too slow when engaging in the region.

DR. DOUGLAS H. PAAL: Well, good afternoon, you dead-enders here, holding on.

This is a great opportunity. Thank you very much, Dave Finkelstein and CNA, for giving me a chance to be back among so many friends and a few new acquaintances here today, and have a chance to comment on the Ambassador of Singapore's maiden speech before the United States' most important audience.

[Laughter.]

DR. DOUGLAS H. PAAL: I am surprised he's even fresh enough and strong enough to make a speech, having been exposed to our political process, two national conventions for the last 2 weeks of our respective parties. He, I'm sure, has learned a lot that he didn't know before he got here.

[Laughter.]

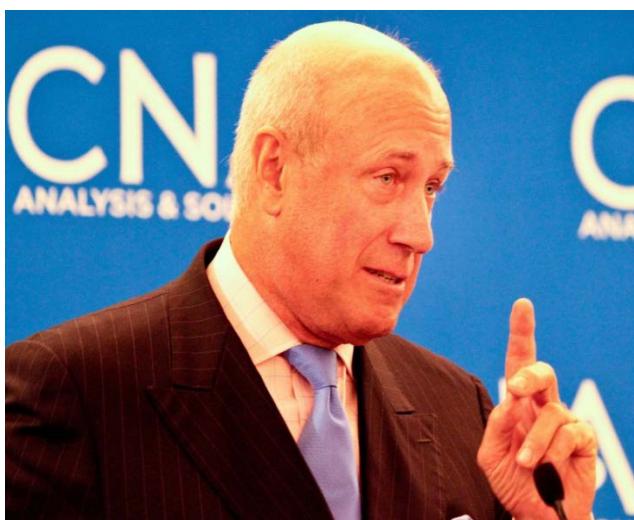
DR. DOUGLAS H. PAAL: Speaking about a Singaporean, it is a chance for me to remind us of something that a few years back, Joe Nye at Harvard Kennedy School made famous, which is that oxygen and security are very similar. You don't notice it until they're gone.

One of the things about Singapore is – and it's been reflected in the remarks indirectly today, the Prime Minister's remarks at the party school, by the way, given in elegant and clear Chinese at the party school – is that countries like Singapore really depend on an orderly global environment. If Singapore and Thailand and Malaysia and claimants in the South China Sea all have to start arming themselves to keep peace in their neighborhood rather than to rely on a large super structure of post-cold war security mechanisms and economic mechanisms to provide for peace and prosperity, the scramble will be hellacious. It will be destructive. It will take us down a path that could ultimately destroy the 21st

century. And what the Ambassador said in his modest phrasing about ASEAN unity, that is an important contribution to regional stability. I think China recognized this.

I look at the outlook regionally for the U.S. and for our friends and allies in the East Asia Pacific region, and I see three rather positive strategic trends. First, I think the correlation of forces, that old Soviet phrase about who's up and who's down, is moving in our favor. That was not the case just a few years ago. Between 1998 and 2008, China, I think wrongly, sensing that the U.S. under Clinton was trying to contain China, surveyed the map and said, "Okay. Where's the soft underbelly of containment?" And they decided to really focus on Southeast Asia. Chinese trade missions, aid missions showed up at an accelerating pace through that decade-long period. China, which is blessed with many leaders, was able to send a leader to each country in ASEAN about once every 3 months, which kept up that personal contact and that warm handshake that the Ambassador mentioned, and we got in that same period somewhat distracted. We didn't ignore Asia. We had things going on in Asia, but we were distracted toward counterterrorism. The time of our leaders was diverted to other things, and we didn't spend as much time on the region as we could have done. And I think that's been changed.

From 2008 to 2010, China, my guess is, got caught up in the success of the Olympics, got caught up in its reasonably effective response to the global financial crisis. It looked down on those who caused the crisis, us among them chiefly, and it started to score "own goals," as the Europeans like to say, with Korea, with Japan, with the Southeast Asian countries. China's arrogant behavior, high-handedness showed up.



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If Singapore and Thailand and Malaysia and claimants in the South China Sea all start arming themselves to keep peace in their neighborhood rather than relying on a super structure of post-Cold War security mechanisms and economic mechanisms to provide for peace and security, the scramble will be hellacious.

But by the end of 2010 and the beginning of 2011, we saw with the diplomatic intercession of Larry Summers and Tom Donilon at the request of President, they were offered a path to a better outcome in U.S.-China relations and regional relations, and by the end of 2010, China accepted that in the form of accepting an invitation for President Hu Jintao to come to Washington on a state visit. And our relationship at the highest level has been in pretty manageable shape. The Ambassador mentioned several recent incidents that were handled effectively. I think that's a direct result of high-level leadership interaction that Jim Steinberg

talked about this morning, where they've developed trust. And the most important thing about trust this year, in a political year, in China and the U.S. is – we are not going to do to you what we hope you won't do to us, a good old Chinese phrase. We're not going to make it harder for your politics if you won't make it harder for ours. And they've managed to work their way through sensitive issues in a very adult fashion.

So I think the correlation of forces, now that the U.S. has reengaged itself, diplomatically, economically, and in security form in East Asia, and that China has sort of scared its neighbors to the point where they have coalesced, not to choose between China and the United States, as the Ambassador points out, but to say to China, "You have to accept us as a whole, as a unit, not pick us off one by one." And that's going to be an important ingredient to maintaining the regional order.

The second major trend, besides this shift in the correlation of forces back towards a more favorable outcome is a coming reversal of fortunes economically.

The Ambassador mentioned the prime minister's speech. I think he, without getting too directly in China's face, sort of made the point. The U.S. is coming back. If you look at America's private sector, household and industrial, corporate, they have been deleveraging from the great financial bubble we had of the period 2001 through 2008 – 2007, 2008, and they have been getting the debt off the books. Now, better economic historians than I have pointed out that when you have a big bubble, you usually have a very long recession, and we're having the political consequences of that, the deadlock in [the U.S.] Congress, a tight election coming up. But if you can look below that political surface to see what's going on in industry and household debt and the like, America is improving its position faster than any other nation on earth.

China, at the same time, is running up even more debts. They're still on the investment model, which people talked about earlier today, and we can go into in Q&A. The investment model is still repressing incomes for the workers and putting the money in the hands of state enterprises and entrepreneurs for the purposes of keeping up rapid growth. This model works up to a point. It worked in Japan until 1990. It worked in Korea until 1998. It worked in Southeast Asia until 1997. There's a point at which you have to transition, and some states transition well, and some face challenges.

The 18th Party Congress is bringing in new leaders who are fully aware of this. I don't think I've ever seen leadership anywhere in the world as able to articulate the challenges they face, but the process which they have – I think Ken Lieberthal touched on this, this morning – is one of consensus. It is very hard to get decisions out of consensus. What you get is resistance,

China is ... still on the investment model of repressing incomes for workers and putting money in the hands of state enterprises and entrepreneurs for the purposes of keeping up rapid growth. This model works to a point ... but there's a point at which you have to transition. The 18th Party Congress is bringing in new leaders who are fully aware of this. I don't think I've ever seen leadership anywhere in the world as able to articulate the challenges they face.

The outlook for China for the next few years is going to be one of mounting challenges to a leadership ill-equipped institutionally to address its challenges.

and not effective decision-making. So China has a big challenge. We could go down the long list of what those challenges imply, but I just leave you with that point that I think the outlook for China for the next few years is going to be one of mounting challenges to a leadership ill-equipped – not personally, but ill-equipped institutionally to address those challenges.

I don't want to underestimate the Chinese. The Chinese in the last 30 years have done tremendous things, and they may make their way to a breakthrough on this set of challenges.

A third strategic trend has also been mentioned by the Ambassador, and that's the regional architecture. The U.S. wasn't really buying into the regional architecture until the Obama administration came along, because of preoccupations elsewhere. But the Chinese themselves, as he said, have bought into ASEAN. China recognized early on that if it tried to shape a regional architecture, the whole region would resist it, but if they could get into the ASEAN slipstream and try to exercise their influence with ASEAN providing reassurance to the neighbors and to the parties more broadly in the world, that it would be a better way to do things. That has been helpful.

We'll have the East Asian Summit to address some important issues later this year. We've just had an APEC meeting, which because of timing is not as celebrated as it should be. Mr. Putin didn't want to have a November meeting in Vladivostok, for reasons anybody who owns a parka can understand.

[Laughter.]

DR. DOUGLAS H. PAAL: So they had it early when our campaign was still on. The President couldn't be there.

But I think this regional architecture, the pursuit of TPP, tepid though it is in the preelection period by the United States, the regional economic robustness, the fact that Indonesia, which is a country the Ambassador knows well, is at the 4 to 4-1/2 percent growth point throughout this post-financial crisis period is a very strong indicator of the success of the Asian economies addressing their problems and meeting their challenges.

Now, having talked about these three trends – the shift in the correlation of forces, economic reversals between the United States and China where we will feel more up and they will feel more down over the next few years – and that, I think, will reinforce some good feeling in a lot of places except China – and then the very initial but promising development of regional architecture, I think there's some tactical concerns that we have.

One is obvious. We have elections coming everywhere. The Japanese will probably have an election this fall. We have just seen the Japanese step out of a period of kind of refusal to listen to sage advice from senior bureaucrats and, therefore, stumbling into trouble with

the Chinese on the Senkakus and other things that were unnecessary problems, to in the last couple of weeks naming four of their best diplomats to four of their key diplomatic posts, which suggests the new leadership under Prime Minister Noda is listening again, after years of LDP and DPJ leaders not listening. That's an encouraging sign, but they are going to have a chance to change Mr. Noda now coming up in the next 2 months.

South Korea faces an election, and there's a pretty big choice in South Korea. U.S. relations with South Korea have never been better than they are now. You will not be able to say that next year, no matter who wins, because it will be different. We also have had elections in Taiwan that seem to go well for all of our interests. We've had elections in Russia, which have raised the Putin factor. Turmoil in India, the Congress Party will probably rest in power for a long time, but that's what they'll be doing. They'll be resting, because they can't move the Lok Satta.

Then we have concern beyond elections, a tactical concern about policy judgment. I just mentioned the Japanese who, I think, are moving in the right direction based on what I've seen in the last few weeks. I hope this helps to calm the situation down in the Senkakus. I think China's response to Japan's most recent moves, the nationalization of the territories that were owned privately in the Senkakus, the Chinese have very carefully issued tough statements that don't go beyond being tough statements. If we're reading it correctly, this means they are putting the lid on the can and taking it off the heat. Let's hope that's the case.

There's still room for policy mistakes. Our own government screwed up on August 3 with a statement from the State Department that sided with the Vietnamese and the Philippines against China in the territorial dispute in the South China Sea. How we did that, why we did it, I kind of know the story. It's not worth me telling here, but it goes to the heart of what was said earlier today about don't incite the Chinese to be unified. They'll be all divided against themselves in all sorts of things, but if you do something wrong that gets into their nationalist craw, you have to expect a nonproductive outcome.

Finally, I wanted to say that one important concern I have – that I hope is tactical and not strategic – is that the challenges I outlined and others have outlined today to China's new leadership are going to present them with temptations in the foreign policy arena. It's not traditionally been the case that China takes its domestic troubles and transfers them abroad. Historians don't find a lot of evidence for that in the PRC or in preceding regimes in China. Nonetheless, it is a temptation, and China is going to be facing unprecedented difficulties because China has never had so many complicated relationships overseas. For 600 years, it hasn't been able to project power overseas, and now it can for the first time, and we've seen in the last year – who knew there were 36,000 Chinese in Libya that would have to be rescued by Chinese Air Force and Naval aircraft? So we are going to just have a more complicated world where

The challenges we have outlined today to China's new leadership are going to present them with temptations in the foreign policy arena. ... For 600 years, [China] hasn't been able to project power overseas, and now it can for the first time.

China has to figure its way out, and like the United States in the 1950s, like Japan in the 1970s, we made a lot of mistakes when we were first swinging our way around Africa and Latin America after the World War II. And Japan when it got rich in the '70s thought it could buy whole entities here and there and wouldn't pay a price, and they had to learn. They have to develop the human resources. They have to learn local ways. They have to learn how to embed themselves without being offensive in places where they want to work and where their interests take them far afield. So that's a set of concerns.

I finally will leave you with these remarks. I think if the strategic picture is pretty solid and we have to prevent tactical errors, the last bit of advice I would have in dealing with the region is the U.S. really needs to resist the temptation to slam on the brakes or to press down on the gas pedal all the time. We tend to either engage sort of overwhelming the issues, whether it's territorial disputes, South China Sea, East China Sea, North-South Korean problems, we either slam on the brakes or we hit the gas. So we've got to learn to sort of step lightly on both pedals, as needed, and that's not an easy skill to acquire. It sounds easy when you talk about it in driving terms, but when it comes to finding the right words, the right gesture, the right time to have something to say or some money to put on the table or offer of technical assistance, that's where the premium will be paid.

The U.S. really needs to resist the temptation to slam on the brakes or to press down on the gas pedal all the time.

Thank you very much.

[Applause.]

Q&A for Session 4

ATTENDEE: Ben Lowsen from the Army Staff. My question is about the Trans-Pacific Partnership and its exclusivity. Do you believe it's too exclusive, or does that exclusivity serve some purpose?

AMBASSADOR ASHOK MIRPURI: It's not an exclusive partnership. It's actually meant to be open, and we hope that this would eventually lead to a free trade area of the Asia Pacific. That is the starting point.

The TPP started with something called the P4, which was much smaller countries, Singapore, Brunei, Chile, and others, and then slowly that's been added on to. Obviously, with the U.S. coming in, that's really become the driving force. And in fact, the past 2 weeks, I've been in another round of negotiations. There are nine countries currently in the TPP. You have North America. You have South America. You have Southeast Asia. The missing gap strategically is Northeast Asia, and we don't want to leave anybody out.

Japan has indicated some interest to come in. They have domestic issues to sort out before they do come in. You have certain issues with Japan with automobiles before they can come in. Canada and Mexico will be joining the next round. They indicated an interest at the G20 meeting, and there is a certain process before they can come in, but they will be coming in the next round, to make it 11 members.

It's always been open to anybody in the region to come in, but at the same time, the TPP is meant to be a standard-setting agreement. You don't want to go for the lowest common denominator. We have a number of agreements, so setting up benchmarks that make it positive for countries in terms of engaging around the region. So it's really not meant to be a closed-up agreement.

There's a view of some people in ASEAN, because only four ASEAN countries are members of the TPP, that it's actually splitting ASEAN, that the focus should be some sort of ASEAN-U.S. FTA. I'm sure ASEAN will welcome that if the U.S. is ready to do that. I don't think there is any real plan to split ASEAN.

There is another perspective that this is meant to contain China, because this is meant to keep China out. Again, I don't believe that that is really the overall approach of a TPP, as they move forward. The countries have to be ready to come in.

DR. DOUGLAS H. PAAL: Well, I'll just add to that. Most Americans don't hear much about TPP because we have an election going on. The Democratic administration, which is quietly at a professional level conducting the technical talks with the other parties to these discussions, is not making it a national platform issue, because they have constituencies that don't welcome Free Trade Agreements, that still resist NAFTA and other of our recent successes in negotiations. And so I think this is something that, should there be a reelection of the Obama administration, you'll hear a lot more about and perhaps will have a change

of personnel in several key positions to people who are quite knowledgeable and effective on trade issues. We haven't had a staff in all the right spots that is steeped in the techniques and the diplomatic skills that Carla Hills brought when she was running our U.S. Trade Representative's office.

AMBASSADOR ASHOK MIRPURI: Just to add to that, the Republicans assured me that they are as committed to TPP as the Democrats when the time comes.

DR. DOUGLAS H. PAAL: Glad to hear that.

[Laughter.]

ATTENDEE: Eric McVadon, the Institute of Foreign Policy Analysis. I'd appreciate it if both of you would comment on the pivot to Asia.

AMBASSADOR ASHOK MIRPURI: Well, it's not a pivot. It's a rebalancing.

I was in Indonesia when all these things were announced. Last year during the EAS when President Obama announced the deployment of troops in Darwin, the additional military engagement with Asia Pacific, actually for the region it was not something new. It was a declared policy, but the U.S. had never gone away.

But, as Doug mentioned, you got distracted by things. The U.S. has always been an Asia Pacific power. You got distracted because of the whole counterterrorism battle in the past 10 years, and so they said we are going to rebalance into Asia. In a way, it also, I think, shifts the U.S. thinking of where the other strategic interests are. The Middle East is still very important and a strategic interest, as is Europe, but it's just starting to put a little bit more effort in there.

From the region, what we'd like to see is a balance, a balanced rebalancing. It shouldn't only be focused on the military. It has to be an economic engagement. It's got to be engagement in other areas of cooperation, so that it doesn't appear to be threatening to anybody. We understand why the U.S. wants to bring this rebalancing in. We welcome it, but we also welcome the broader engagement that has always been there. U.S. companies have got hundreds of billions of dollars of investments in Southeast Asia, and more were coming in. They never went away. If you look at the register of U.S. companies in Southeast Asia, all your major players are there. So we were not too concerned about it, but sometimes the language makes people a little bit uncomfortable about how they do it.

What we'd like to see is a balanced rebalancing. It shouldn't only be focused on the military. It has to be an economic engagement, engagement in other areas of cooperation, so that it doesn't appear to be threatening to anybody.

DR. DOUGLAS H. PAAL: Eric, a lot of older people like ourselves were pleased to welcome an effort to develop a comprehensive approach to the Asia Pacific region and a more positive attitude to the emerging regional architectures that are developing there.

The diplomatic – Mrs. Clinton going out engaging at meetings that Condi Rice had missed, the President going to the East Asian Summit for the first time – the economic, the TPP proposals, others, and the military. We're not putting new force levels into Asia. We're protecting our force levels in Asia from the meat ax of upcoming budget cuts. So it's a floor, not a ceiling that's been described.

However, in the marketing of this concept, it moves from guys who do foreign policy and talk to ambassadors every day to the guys who do politics and talk to the press every day, and they started talking up, well, this is really going to show we're tough on China; in fact, we and Obama's administration are tougher than Romney on China. And you start losing the grip.

And the worst thing that happens is when DoD gets ahold of it, because they're the only people in town with money, and they've got the biggest megaphones. And suddenly, we've got every admiral, every general, every civilian military leader out explaining the rebalancing. So, on that basis, I have gone into the people we all know and said, "Let's cut the rebalancing and pivot language for a while. I can tell you from going to China and elsewhere in East Asia, it's become counterproductive." That's not what we're doing. What we're doing is what we should do. Talking about it all the time in this high-blown rhetoric is what's making people think it's more than it is. We're giving people reason to fear things that they ought to be reassured by. That's what I mean by the gas pedal and brake. You got to know when to take it off the gas and put it back on the brake on the rhetoric.

ATTENDEE: I had a question. Perhaps a decade ago, there was a great feeling that in the divide between the western world and the Islamic world, your ASEAN countries having such a large Muslim population were in play and somehow going to be swayed in one direction or the other. Today, what is the view of the ASEAN countries about their Muslim populations and the influence that they can play in the greater dialogue between the world of Islam and the rest of the world?

AMBASSADOR ASHOK MIRPURI: All ASEAN countries have large Muslim populations. Indonesia has maybe the largest Muslim population in the world in absolute numbers. Malaysia has a majority Muslim population. There is a Muslim population in Singapore, with 14 percent Muslims in Singapore. Thailand, the Philippines, all have Muslim populations.

Southeast Asian Islam is different from Middle East Islam. That's the conclusion that I think many people have come to. It's an Islam that is very focused on economic development. Because they all go for the Hajj the model is still the Middle East, but what they are trying to develop – and this is particularly led by the Indonesians – is their own perspectives on Islam, which if you go to Indonesia, it has got layers of Hinduism and Buddhism. So what

the Indonesians are doing and some of the other countries are joining them is talking about interfaith relationships.

Islam will be a factor in some of the policy-making, some of the responses from Indonesia, Malaysia, Brunei, all members of the OIC. So some of the responses become the global Islamic responses, how they deal with it. How they deal with the issue of relations with Israel is one factor, because of the Islamic communities in their countries, but Indonesia, Malaysia, Singapore have been as strong on the battle of counterterrorism, which brought in a large number of Islamic Jihadists to the region as well. So we were as impacted by 9/11 as anybody else. It's a little bit different from Middle East Islam.

DR. DOUGLAS H. PAAL: I completely agree with what the Ambassador has said, and I would underscore the effectiveness of Indonesia's police forces in following constitutional procedures and traditional police methods to apprehend major threats from radical Islam elements.

What I would add to it is – I don't want to leave an impression of complacency about Southeast Asia. I've been in Indonesia when Israel went into Gaza, and we never saw on our TV screens in America the blood and gore that you could see on the TV screens of Indonesia or Malaysia at that time. And our policies and our friends' policies can intersect in a very emotional way, and you can't expect the Muslims of Southeast Asia to be docile. It's unfortunate that we've had this horrible episode in Libya today and in Egypt. So it requires care in handling.

ATTENDEE: I am afraid I speak without the benefit of having seen the morning session with Dr. Lieberthal when perhaps discussions of Xi Jinping and some of that went on, and without engaging in rumormongering, my question would be, at what point does this silence about his fate become an issue for neighbors and partners. I mean, I think we can politely give the benefit of the doubt that there is an understandable explanation, but at some point, is it a vacuum? Is it something that we legitimately worry about? Do we offend the Chinese by even asking such question?

AMBASSADOR ASHOK MIRPURI: This question was asked to me a couple of days earlier as well.

Last month, Lee Kuan Yew disappeared from the screens, and there were all these rumors that he had passed away. And the Singapore government did not say anything. A few days later, we had our National Day, and he turned up and waved at everybody to loud cheer. I guess the Chinese will have to manage how they do the media around these issues as well as how to respond to every rumor.

My prime minister was supposed to meet Xi Jinping last week. He also has a meeting with Secretary Clinton. And do you respond to every rumor? I think it's a sort of the case of China understanding that there is a greater interest in terms of how their future leaders are being viewed, and yet giving the leadership some privacy. If he wants to take a vacation, let him take a vacation for a while.

DR. DOUGLAS H. PAAL: The *Washington Post* this morning had an editorial on this subject, and as is often the case with *Washington Post* editorials, it assumed that our values are their values, our assumptions are their assumptions. So it assumes that the Chinese people will be up in arms over the lack of transparency about the leadership.

The Chinese people don't get a big vote in the 18th Party Congress, and the people who do probably all know exactly where he is and what he's doing. So it's just a different set of references, and it's very hard for us to come in and say what date is it going to be, by which – certainly by the 18th Party Congress, unless they've got different plans, he ought to be making an appearance, but they can always choose when the 18th Party Congress takes place.

Like Lee Kwan Yu, Jiang Zemin was subjected to these rumors. Was it a year ago or 2 years ago? I can't remember now, but he was not seen for quite a while, and everybody said he had died. And then he turned up eventually, and they are quite more accustomed to that in China than we are. The westernized people on the Weibo in China are starting to Twitter about this, but it's not something you see as a very important issue among the people yet.

DR. THOMAS BICKFORD: Please join me in thanking our panel.

[Applause.]

DR. DAVID FINKELSTEIN: We have come to the end of our very long day here, and I would like to thank you all again for coming and participating. Thanks again to Ambassador Mirpuri. We are very grateful to the Government of Singapore for having him be available.

There is going to be a conference report that comes out of this, and all of you who are invited will be sent this conference report when it is done. I am not going to presuppose what is going to be in that conference report, but as I thought about what I heard throughout the day, there were probably four or five big takeaways for me, blazing flashes of the obvious really, but sometimes even the obvious deserves to be admired.

The first takeaway for me is, after 40 years of relations with the People's Republic of China, isn't it remarkable what we still don't know about how this political system works, how leaders are chosen, and how things happen behind the screen? It is truly a thing of wonderment that we are speculating as we are about the Chinese leadership, one of the major powers of the 21st century.

Second, for China's leaders, it is probably going to be all about domestic issues. So, when this new fifth generation comes in, it is going to be about domestic issues, but there is a big "however" associated with that, because China's domestic well-being is now inextricably linked with the external world and the larger international order. So while it's all going to be about domestic issues, even the external and the international is going to matter for the Chinese.

Third, economics and security issues are going to both bind the U.S. and China together and also be the two great sources of contention.

Fourth, China's domestic affairs and domestic politics may no longer be Chinese domestic issues. Indeed, as a *da guo*, as a major country in the international system, people are paying attention to what goes on in China's domestic politics, just as the world watches presidential elections here in the United States.

And finally, leaders do matter. There are a lot of institutional and systemic forces that are going to impel or constrain Chinese leaders from making the policy choices they need to make, but as Jim Steinberg alluded to earlier in the day, leaders can make a tremendous difference. And once again, we were sensitized to the fact that not only is China going to undergo a major leadership change, but regardless of which party wins the election here in the U.S., the U.S. is about to undergo a leadership change in many critical spots as well.

So thank you all for coming. It's been terrific. We thank you for your support over many years. Thank you so much.

[Applause.]

After 40 years of relations with the People's Republic of China, isn't it remarkable what we still don't know about how this political system works, how leaders are chosen, and how things happen behind the screen?



Cover photo credits:

Left: REUTERS/Claro Cortes. (October 21, 2007) Communist leaders and delegates stand while the national anthem is played during the concluding session of the 17th Party Congress at the Great Hall of the People in Beijing.

Right: REUTERS/Jason Lee. (November 8, 2012) China's Vice President Xi Jinping (top) walks behind as President Hu Jintao (L) talks with former President Jiang Zemin (R) at the start of the opening ceremony of the 18th National Congress of the Communist Party of China at the Great Hall of the People in Beijing.

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